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**Canadian Energy**  
SERVICES LP

PRODUCTS  
PEOPLE  
PROCESSES

2007 ANNUAL REPORT

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## TABLE OF CONTENTS

1

Message From the President &  
Chief Executive Officer

2

Management's Discussion and Analysis

24

Consolidated Financial Statements

### Inside Back Cover

Partnership Information

We executed our business plan in 2007 despite significant headwinds. We managed our business responsibly in a tough drilling market and steadily grew market share in the Western Canadian Sedimentary Basin by delivering a compelling value proposition to our customers. We followed through on our commitment to unitholders and paid our distributions in full while maintaining a strong balance sheet. We implemented our growth initiatives by developing an integrated logistics and transportation network in northwest Alberta, establishing a toehold in the robust United States market and accessing promising international opportunities. In short, we have positioned CES to be the leading technologically driven drilling fluids provider in our target markets.

# Message From The President and Chief Executive Officer

I view 2007 as a year when the Partnership kept commitments. Canadian Energy Services L.P. has many stakeholders: customers, employees, suppliers and unitholders. Striking the right balance explains our success and leaves the Partnership poised for a terrific future.

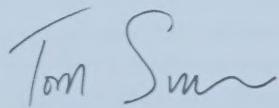
For our customers, 2007 was a watershed year; our commitment to them never meant more. Operators saw margins squeezed, so for services such as our drilling fluids that legitimately lower drilling costs or improve productivity, the service company and customer became more aligned than ever. Our ability to work with our customers, including southeast Saskatchewan horizontal drilling, Alberta oilsands, and deep horizontal drilling for tight gas, allowed us to increase market share in a competitive environment. Results through technology and execution ruled the day in 2007.

For our employees, I hope 2007 was a positive year. The Partnership invested in technical and safety training and we grew our ranks to maintain our commitment to service excellence. CES remains committed to providing a safe, rewarding work environment and I take great pride in our near-zero turnover of people.

For our suppliers, we represent a reliable and growing work partner. CES integrated its processes, invested in procurement and built out our own fleet of trucks to move our products. Our ability to evolve, with our commitment to emerging technologies like Seal-AX™ (Patent Pending), distinguishes us from our competitors.

CES also kept its commitments to unitholders. We executed our business plan in 2007 despite significant headwinds. We managed our business responsibly in a tough drilling market and steadily grew market share in the Western Canadian Sedimentary Basin by delivering a compelling value proposition to our customers. We followed through on our commitment to unitholders and paid our distributions in full while maintaining a strong balance sheet. We implemented our growth initiatives by developing an integrated logistics and transportation network in northwest Alberta, establishing a toehold in the robust United States market and accessing promising international opportunities. In short, we have positioned CES to be the leading technologically driven drilling fluids provider in our target markets.

As successful as 2007 was for CES, I do believe that 2008 and beyond offer even greater promise. It is with a debt of gratitude that I thank our customers for their trust and business. To our employees, you make my job easier, and I am proud to work with you all; we have an incredible team with great momentum. To the board and my fellow officers, thank you for the leadership and dedication. As we expand our business to new geographical areas, our mettle will be tested. I am excited about the challenge and look forward to reporting on our progress throughout the new year.



Thomas J. Simons  
President and Chief Executive Officer

# Management's Discussion and Analysis

The following management's discussion and analysis ("MD&A") of financial condition and results of operations should be read in conjunction with the audited consolidated financial statements and notes thereto, of Canadian Energy Services L.P. ("CES" or the "Partnership") as at and for the year ended December 31, 2007 and the 305-day period ended December 31, 2006. The information contained in this MD&A was prepared up to and including February 29, 2008 and incorporates all relevant considerations to that date.

Certain statements in this MD&A may constitute "forward-looking information" which involves known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Partnership, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. When used in this MD&A, such information uses such words as "may", "would", "could", "will", "intend", "expect", "believe", "plan", "anticipate", "estimate" and other similar terminology. This information reflects the Partnership's current expectations regarding future events and operating performance and speaks only as of the date of the MD&A. Forward-looking information involves significant risks and uncertainties, should not be read as a guarantee of future performance or results, and will not necessarily be an accurate indication of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking information, including, but not limited to, the factors discussed below. Although the forward-looking information contained in this MD&A is based upon what management of the Partnership believes are reasonable assumptions, the Partnership cannot assure readers that actual results will be consistent with this forward-looking information. This forward-looking information is provided as of the date of this MD&A, and, subject to applicable securities laws, the Partnership assumes no obligation to update or revise such information to reflect new events or circumstances.

In particular, this MD&A contains forward-looking information pertaining to the following: future estimates as to distribution levels; capital expenditure programs for oil and natural gas drilling; supply and demand for drilling fluid systems and industry activity levels; commodity prices; treatment under governmental regulatory and taxation regimes; dependence on equipment suppliers and equipment improvements; dependence on personnel; collection of accounts receivable; operating risk liability; expectations regarding market prices and costs; expansion of services in Canada, the United States and internationally; development of new technology; acquisition of trucking capacity; and competitive conditions.

The Partnership's actual results could differ materially from those anticipated in the forward-looking information as a result of the following factors: general economic conditions in Canada, the United States and internationally; demand for oilfield services for drilling and completion of oil and natural gas wells; volatility in market prices for oil, natural gas and natural gas liquids and the effect of this volatility on the demand for oilfield services generally; competition; liabilities and risks, including environmental liabilities and risks, inherent in oil and natural gas operations; sourcing, pricing and availability of raw materials, consumables, component parts, equipment, suppliers, facilities, and skilled management, technical and field personnel; ability to integrate technological advances and match advances of competitors; availability of capital; uncertainties in weather and temperature affecting the duration of the oilfield service periods and the activities that can be completed; changes in legislation and the regulatory environment, including uncertainties with respect to programs to reduce greenhouse gas and other emissions, taxation of trusts, public partnerships and other flow-through entities, and changes to the royalty regimes applicable to entities operating in the Western Canadian Sedimentary Basin; fluctuations in foreign exchange and interest rates and the other factors considered under "Risk Factors" in the Partnership's Annual Information Form for the period ended December 31, 2007 and "Risks and Uncertainties" in this MD&A.

Without limiting the foregoing, the forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.

## FINANCIAL HIGHLIGHTS

FINANCIAL RESULTS	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>	% Change <sup>5</sup>
(\$000's, except per unit amounts)			
Revenue	60,420	46,013	31
Gross margin <sup>2</sup>	19,075	13,184	45
Net earnings (loss) before taxes	9,302	(26,809)	n/m
per unit – basic and diluted <sup>3</sup>	0.99	(2.93)	n/m
Net earnings (loss)	7,301	(26,809)	n/m
per unit – basic and diluted <sup>3</sup>	0.78	(2.93)	n/m
EBITDAC <sup>2</sup>	10,453	7,521	39
Funds flow from operations <sup>2</sup>	10,410	7,641	36
per unit – basic and diluted <sup>3</sup>	1.11	0.83	34
Distributions declared	8,916	7,275	23
per Class A Unit	0.9504	0.7920	20
per Subordinated Class B Unit	0.9504	0.7920	20
FINANCIAL POSITION	Dec 31, 2007	Dec 31, 2006	% Change
(\$000's)			
Working capital	7,552	10,920	(31)
Total assets	77,070	74,910	3
Long-term financial liabilities <sup>4</sup>	1,289	616	109
Unitholders' equity	53,047	54,494	(3)
PARTNERSHIP UNITS OUTSTANDING <sup>3</sup>	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>	% Change
End of period	9,380,946	9,380,946	-
Weighted average - basic	9,380,946	9,152,574	2
- diluted	9,383,215	9,166,542	2

### Notes:

<sup>1</sup> From commencement of operations on March 2, 2006.

<sup>2</sup> Refer to the "Non-GAAP Measures" on page 5 for further detail.

<sup>3</sup> Includes Class A Units and Subordinated Class B Units (see "Unitholders' Equity" on page 15).

<sup>4</sup> Vehicle financing loans and term loan excluding current portions.

<sup>5</sup> Readers should be cautioned that the year ended December 31, 2007 is not directly comparable to the 305-day period ended December 31, 2006 due to the shorter period in 2006.

n/m – Calculation is not meaningful.

## OVERVIEW OF FINANCIAL AND OPERATIONAL RESULTS

Highlights of the year ended December 31, 2007 in comparison to the 305-day period ended December 31, 2006 for CES were:

- The Partnership generated revenue of \$60.4 million for the year ended December 31, 2007, an increase of 31% over the 305-day period ended December 31, 2006. This increase primarily arose from the additional months of January and February in the 2007 results but also reflected a 5% increase for the comparable period from March through December. Overall industry activity dropped 32% from an average rig count in 2006 of 502 to 339 in 2007 based on industry published data for Western Canada. CES increased its market share in 2007 which was estimated to be 17% for the year. CES' market share had grown from an estimated 10% in March, 2006 to 16% in the last quarter of 2006.

- Gross margin of \$19.1 million or 32% of revenue was generated for the year which, as a percentage of revenue, was higher than the 29% gross margin generated in the 305-day period ended December 31, 2006. The increase in margin was primarily due to the reduced level of sales of low margin base oil in 2007 in comparison to 2006 and to the impact of improved procurement strategies.
- Selling, general and administrative costs were \$8.6 million for the year, in comparison to \$5.7 million for the 305-day period ended December 31, 2006. This increase related to having a full year of operations in 2007, successfully attracting experienced and qualified key personnel over the year and an increase in commissions payable on higher sales revenues.
- Net earnings were \$7.3 million for the year ended December 31, 2007, which included a charge of \$2.0 million for future income taxes that resulted from the new tax imposed on public partnerships in 2007. Earnings before future income taxes for the year ended December 31, 2007 were \$9.3 million, which was 15% of revenue and \$0.99 per unit. For the 305-day period ended December 31, 2006, CES reported a net loss of \$26.8 million, which included a charge for goodwill impairment of \$34.0 million. Excluding the impact of the goodwill impairment charge, 2006 net earnings were \$7.2 million, which was 16% of revenue and \$0.78 per unit.
- The Partnership maintained its monthly distributions throughout the year at its target level of \$0.0792 per unit to Class A unitholders. Quarterly distributions of \$0.2376 were declared to the Subordinated Class B unitholders. The payout ratio (refer to "Non-GAAP Measures" on page 5) was 90% for the year ended December 31, 2007, in comparison to 109% for the 305-day period ended December 31, 2006. The determination of the payout ratio does not take into account changes in non-cash operating working capital items. Management continues to believe that an annualized target payout ratio of 80% is appropriate for the Partnership's business over the long term given the relatively low level of capital required to maintain and grow the business. The Board of Directors reviews the distributions on a monthly and quarterly basis in light of industry conditions, growth opportunities requiring expansion capital and management's forecast of distributable funds.
- Working capital was \$7.6 million at December 31, 2007 and CES' long-term debt, represented by vehicle financing loans and a term loan, was \$1.3 million. CES continued to maintain a strong balance sheet that positions the Partnership to capitalize on growth opportunities.
- On February 26, 2008, CES secured new financing with a commercial bank to borrow up to \$12.0 million on a demand revolving loan facility based on the value of certain trade receivables and inventory. In addition, two committed loans were established to borrow up to a total of \$2.75 million for CES' Edson, Alberta facility and related equipment. The actual capital expenditures for the Edson facility were \$4.1 million and they were funded partially by a \$1.0 million term loan and the balance from available cash flow and the operating line. These new facilities were used to repay and cancel the Partnership's bank debt that was in place at December 31, 2007.

## OVERVIEW OF THE PARTNERSHIP FORMATION AND THE CORPORATE STRUCTURE

The Partnership is a limited partnership formed on January 13, 2006 under the *Limited Partnerships Act (Ontario)*. The Partnership was organized in accordance with and is governed by the terms and conditions of a limited partnership agreement dated January 13, 2006 as amended and restated on March 2, 2006 (the "Partnership Agreement"). The Partnership's business and affairs are managed by Canadian Energy Services Inc. (the "General Partner") pursuant to the Partnership Agreement. A copy of the Partnership Agreement is available on the Partnership's SEDAR profile at [www.sedar.com](http://www.sedar.com).

The General Partner was incorporated on December 9, 2005 under the *Business Corporations Act (Alberta)*. The General Partner is authorized to carry on the business of the Partnership and has full power and exclusive authority to administer, manage, control, and operate the business of the Partnership. The Partnership reimburses the General Partner for all direct costs and expenses incurred in the performance of those duties.

The Partnership commenced business operations on March 2, 2006 when it acquired the businesses of two private drilling fluids companies (see "Business Acquisitions" on page 14). CES designs and implements drilling fluid systems for the oil and gas industry, in particular, relating to drilling medium to deep vertical and directional wells and horizontal wells in the Western Canadian Sedimentary Basin ("WCSB").

CES Operations Ltd., a wholly-owned subsidiary of the Partnership, was incorporated on September 22, 2006. AES Drilling Fluids, LLC (formerly American Energy Services, LLC), a Delaware limited liability company of which CES Operations Ltd. is the sole shareholder, was formed on November 28, 2006. Each of the foregoing companies was formed in connection with the Partnership's operational expansion strategy into the United States.

## NON-GAAP MEASURES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain supplementary information and measures not recognized under GAAP are also provided in this MD&A where management believes they assist the reader in understanding the Partnership's results. These measures are calculated by CES on a consistent basis unless otherwise specifically explained. These measures are further explained as follows:

**Distributable funds** – means funds flow from operations less maintenance capital. See the definition of funds flow from operations below and the definition of maintenance capital under "Operational Definitions" on page 6. Distributable funds is a measure used by management and investors to analyze the amount of funds available to distribute to unitholders before consideration of funds required for growth purposes. Refer to "Liquidity and Capital Resources – Funds Flow from Operations and Distributions" on page 12 for the calculation of distributable funds.

**EBITDAC** – means net earnings before interest, taxes, amortization, loss on disposal of assets, goodwill impairment and unit-based compensation. EBITDAC is a metric used to assess the financial performance of an entity. Management believes that this metric assists in determining the ability of CES to generate cash from operations. EBITDAC was calculated as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
<b>(\$000's)</b>		
Net earnings (loss)	7,301	(26,809)
Add back (deduct):		
Amortization	913	345
Impairment of goodwill	-	34,000
Unit-based compensation	168	105
Interest expense, net of interest income	43	(120)
Loss on disposal of assets	27	-
Future income tax expense	2,001	-
<b>EBITDAC</b>	<b>10,453</b>	<b>7,521</b>

*Note:*

<sup>1</sup> From commencement of operations on March 2, 2006.

**Funds flow from operations** – means cash flow from operations before changes in non-cash operating working capital. This measure is not intended to be an alternative to cash provided by operating activities as provided in the consolidated statements of cash flow, net earnings or other measures of financial performance calculated in accordance with GAAP. Funds flow from operations assists management and investors in analyzing operating performance and leverage. Funds flow from operations was calculated as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
<b>(\$000's)</b>		
Cash provided by operating activities	4,386	9,859
Adjust for:		
Change in non-cash operating working capital	6,024	(2,218)
<b>Funds flow from operations</b>	<b>10,410</b>	<b>7,641</b>

*Note:*

<sup>1</sup> From commencement of operations on March 2, 2006.

**Gross margin** – means revenue less cost of sales, which represents cost of product, field labour and all field related operating costs. Management believes this metric provides a good measure of the operating performance at the field level. It should not be viewed as an alternative to net earnings.

**Payout ratio** – means distributions declared as a percentage of distributable funds. Refer to "Liquidity and Capital Resources – Funds Flow from Operations and Distributions" on page 12 for the calculation of the payout ratio.

These measures do not have a standardized meaning as prescribed by GAAP and are therefore unlikely to be directly comparable to similar measures presented by other companies, trusts or partnerships.

## OPERATIONAL DEFINITIONS

**Expansion capital** – represents the amount of capital expenditure that has or will be incurred to grow or expand the business or would otherwise improve the productive capacity of the operations of the business.

**Maintenance capital** – represents the amount of capital expenditure that has been or will be incurred to sustain the current level of operations.

**Market share** – CES estimates its market share by comparing, on a semi-weekly basis, active rigs where the Partnership was contracted to provide services to the total active rigs for Western Canada. Active rigs, in both cases, included operating rigs, rigs on standby (i.e. waiting on weather) and rigs that were moving. Total active rigs for Western Canada are based on Canadian Association of Oilwell Drilling Contractors (“CAODC”) published data for Western Canada.

**Operating days** – CES estimates its operating days, which are revenue generating days, by multiplying the average number of active rigs where the Partnership was contracted to provide services by the number of days in the period.

**Well type** – the Partnership classifies oil and natural gas wells by depth, as follows:

- shallow wells:** generally less than 1,000 metres;
- medium wells:** generally between 1,000 and 2,500 metres;
- deep wells:** generally greater than 2,500 metres; and
- horizontal wells:** drilled vertically then horizontally, often with multiple lateral legs, reaching out 500 to 1,500 metres each.

## RESULTS FOR THE PERIODS

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>	\$ Change <sup>3</sup>	% Change <sup>3</sup>
(\$000's, except per unit amounts)				
Revenue	60,420	46,013	14,407	31
Cost of sales	41,345	32,829	8,516	26
Gross margin <sup>2</sup>	19,075	13,184	5,891	45
% of revenue	32%	29%		
Selling, general and administrative expenses	8,622	5,663	2,959	52
Amortization	913	345	568	165
Impairment of goodwill	-	34,000	(34,000)	n/m
Unit-based compensation	168	105	63	60
Loss on disposal of assets	27	-	27	n/m
Interest expense, net of interest income	43	(120)	163	n/m
Net earnings (loss) before taxes	9,302	(26,809)	36,111	n/m
Future income tax expense	2,001	-	2,001	n/m
Net earnings (loss)	7,301	(26,809)	34,110	n/m
per unit – basic and diluted	0.78	(2.93)	3.71	n/m

Notes:

<sup>1</sup> From commencement of operations on March 2, 2006.

<sup>2</sup> Refer to the “Non-GAAP Measures” on page 5 for further detail.

<sup>3</sup> Readers should be cautioned that the year ended December 31, 2007 is not directly comparable to the 305-day period ended December 31, 2006 due to the shorter period in 2006.

n/m – Calculation is not meaningful.

## Revenue and Operating Activities

The Partnership generated revenue of \$60.4 million for the year, an increase of 31% over the 305-day period ended December 31, 2006. This increase primarily arose from the additional months of January and February in the 2007 results but also reflected a 5% increase for the comparable period from March through December. Adjusting for the reduced level of sales of low margin base oil in March through December of 2007 in comparison to the same period in 2006, the increase in revenue was 11%.

The active rig count in Western Canada averaged 339 for the year in 2007 based on CAODC published monthly data for Western Canada. This was a 32% drop from the average rig count of 502 in 2006. The level of industry activity in 2007 was the lowest it had been in the last five years. As of February 26, 2008, there were 571 active rigs reported by CAODC, which compares to 591 a year earlier.

CES estimated its market share in 2007 was 17%. CES' market share had grown from an estimated 10% in March, 2006 to 16% in the last quarter of 2006.

The top five customers of the Partnership accounted for approximately 29% of revenue in 2007, with the largest customer, a major exploration and production company, at 9%. For the 305-day period ended December 31, 2006, the Partnership's top five customers accounted for 27% of revenue, with the largest customer at 8%.

The Partnership estimated operating days as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Operating days	20,143	14,408

Note:

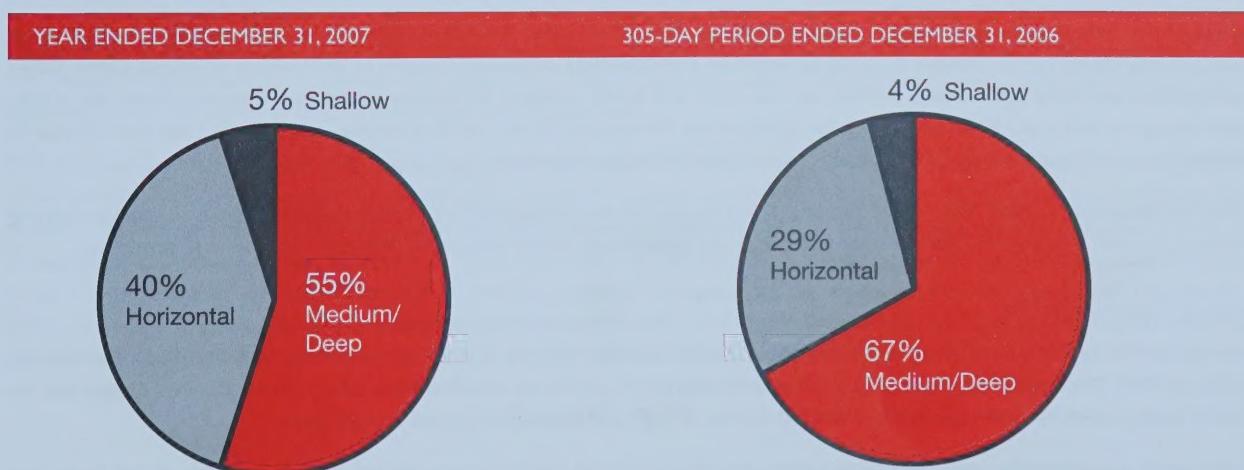
<sup>1</sup> From commencement of operations on March 2, 2006.

CES' revenue mix has evolved from 2006 with a reduced level of low margin base oil sales, increased product and service revenue (even after adjusting for the additional two months of operations in 2007) and the commencement of trucking operations in 2007 for both the Moose Mountain Mud division in southeast Saskatchewan and the new EQUAL Transport operations based in Edson, Alberta. Trucking contributed 2% of CES' revenue in 2007.

The Partnership also generated incremental revenue resulting from the introduction of new technology based drilling fluids, such as Seal-AX™ (Patent Pending) in the foothills and Poly-Core in the oilsands, which resulted in a shift of its customer base to include key major exploration and production companies.

Overall, CES continued to focus on medium to deep drilling and horizontal drilling which collectively represented approximately 95% of revenue for the year ended December 31, 2007. CES' experience has been that the importance to the operator of drilling fluid systems' increases significantly with the depth and complexity of the well drilled.

The following charts illustrate the Partnership's estimated revenue by well type in CES' targeted areas:



## **Cost of Sales and Gross Margin**

Gross margin of \$19.1 million, or 32% of revenue, was generated for the year in 2007. Gross margin was 29% of revenue for the 305-day period in 2006. Gross margin represents the profit earned on revenue after deducting the cost of products, field labour and all related field costs. Margins can vary due to a change in product mix.

Margins have increased from 2006 primarily due to reduced level of sales of low margin base oil in 2007 in comparison to 2006 and the impact of cost effective procurement strategies that CES had implemented in 2007. As the most significant cost of field operations is product costs, the Partnership will stay focused on product procurement opportunities in 2008.

Cost of labour has less of an impact on margins as activity increases. Use of consultants and the variable component of compensation for employees provides a means to manage seasonal activity swings. Despite the reduced levels of industry activity from last year, CES has increased its operating days and increased its investment in personnel. CES field staff increased from an average headcount of 27 in 2006 to 38 in 2007, a 41% increase. The increased field staff was required to accommodate the sustained increase in market share growth. CES is committed to the continued recruiting, training and retention of quality field personnel to ensure quality customer service at the well site.

## **Selling, General and Administrative Expenses (“SG&A”)**

SG&A for the year ended December 31, 2007 was \$8.6 million, an increase of \$3.0 million (52%) from the 305-day period ended December 31, 2006. This increase was primarily due to the additional months of January and February in the 2007 results, but also related to successfully attracting experienced and qualified key personnel over the year and an increase in commissions payable on higher sales revenue.

CES had an average of 27 employees included in SG&A in 2006. This increased 15% to 31 in 2007. Key personnel were recruited over the last year in sales, finance and technical support.

Although sales commissions are directly related to revenue generated, the increase in sales personnel has resulted in a higher proportion of revenue that is now subject to commissions. Revenue generated by executive management is not commissionable.

The Partnership continues to be focused on overall cost control for SG&A.

## **Goodwill Impairment**

Effective November 1, 2006 the Partnership completed its first annual goodwill impairment test in accordance with the Partnership's accounting policies. Management estimated, with the assistance of an independent business valuator, the fair value of the reporting unit using a number of industry accepted valuation methodologies including discounted future cash flows, comparable industry valuation multiples, recent trading activity and capital market pricing of the Partnership's units. Management concluded that a reduction in the carrying value of goodwill was required and a goodwill impairment charge of \$34.0 million was taken in the period ended December 31, 2006.

Management believed this determination of goodwill impairment did not affect the future prospects of CES' underlying business, but was primarily driven by the October 31, 2006 government announcement proposing changes to the taxation of income funds, public partnerships and other flow-through entities, such as CES, and broad softening of industry conditions. This write-down was a non-cash charge to earnings. It did not impact the ability of the Partnership to carry on its business, generate its cash flows or pay its distributions. CES continued to have a strong balance sheet after the write-down.

Effective November 1, 2007, the Partnership completed its second annual goodwill impairment test and concluded that the carrying value of goodwill was less than the estimated fair value and therefore no further reduction in the carrying value was necessary.

## **Other Expense Items**

Amortization of property, equipment and intangibles was \$913,000 for the year in 2007 in comparison to \$345,000 for the 305-day period in 2006. The increase largely related to the investment in trucks which are amortized on a straight-line basis over 5 years and the Edson facility which became operational in the last quarter of 2007 and is being amortized over 20 years.

Unit-based compensation was determined using the Black-Scholes option pricing model and expensed over the three year vesting period.

Loss on disposal of assets of \$27,000 in 2007 primarily related to the disposal of field vehicles.

Interest expense, net of interest income, consists of interest expense on vehicle financing loans, the term loan and the operating loan less interest earned on short-term investments.

## Future Income Taxes

On June 22, 2007 the Government of Canada enacted new legislation imposing an additional income tax ("SIFT tax") upon specified investment flow-through entities ("SIFTs"), including public partnerships such as Canadian Energy Services L.P. Since the income of the Partnership was not previously subject to tax, no future income taxes were recognized on temporary differences between amounts recorded on its balance sheet for book and tax purposes. Provided the Partnership does not exceed "normal growth" (discussed below) in the interim, it will not be subject to SIFT tax until 2011.

Based on its assets and liabilities as at December 31, 2007, the Partnership estimated the amount of its temporary differences which were previously not subject to tax and the period in which these differences will reverse. Details of taxable (deductible) temporary differences are as follows:

(\$000's)	Dec 31, 2006	Dec 31, 2007	Jan 1, 2011
Property and equipment	(287)	13	(303)
Goodwill	(598)	1,648	7,483
IPO underwriting costs originally netted with unitholders' capital	(4,201)	(3,160)	(34)
Net taxable (deductible) temporary differences	(5,086)	(1,499)	7,146
Tax rate	n/a	n/a	28%
Future income taxes	n/a	n/a	2,001

Note:

n/a - Not applicable.

The Partnership estimated that the net deductible temporary differences existing at December 31, 2007 will reverse at a nil tax rate. The Partnership also estimated that \$7.1 million of net taxable temporary differences will reverse after January 1, 2011, resulting in a \$2.0 million future income tax liability. The taxable temporary differences relate principally to the projected excess of net book value of goodwill over the projected remaining tax pools attributable thereto at January 1, 2011.

As the legislation gave rise to a change in the Partnership's estimated future income tax liability in the period, the recognition of the liability was accounted for prospectively and \$2.0 million of future income tax expense was recorded for the year ended December 31, 2007. This charge is a non-cash item and does not currently impact the ability of the Partnership to carry on its business, generate its cash flows or pay distributions.

While the Partnership believes it will be subject to tax under the new legislation, the tax rate on temporary difference reversals after 2010 may change in future periods. The amount and timing of reversals of temporary differences will also depend on the Partnership's future operating results, financings and asset acquisitions and dispositions.

SIFT tax does not apply to a SIFT that was publicly traded on October 31, 2006 until 2011 unless the SIFT exceeds "normal growth" in the interim period as determined by reference to guidelines released on December 15, 2006. Under those guidelines, normal growth is an increase of equity capital (including new securities convertible into equity, but excluding equity issued on the conversion of convertible securities existing on October 31, 2006) each year until 2011 of not more than an amount equal to the greater of \$50.0 million and a cumulative safe harbour amount (a specified portion of its market capitalization as of the end of trading on October 31, 2006). Since the Partnership's market capitalization at the close of trading on October 31, 2006 was \$52.4 million, its maximum normal growth limit is the general \$50.0 million limit for each of 2008, 2009 and 2010.

## QUARTERLY FINANCIAL SUMMARY

	Three Months Ended Dec 31, 2007	Three Months Ended Sep 30, 2007	Three Months Ended Jun 30, 2007	Three Months Ended Mar 31, 2007
<b>FINANCIAL RESULTS</b>				
(\$'000's, except per unit amounts)				
Revenue	18,600	16,104	6,198	19,518
Gross margin <sup>2</sup>	5,773	5,337	1,444	6,521
Net earnings (loss)	3,292	3,037	(2,955)	3,927
per unit – basic and diluted <sup>3</sup>	0.35	0.32	(0.32)	0.42
EBITDAC <sup>2</sup>	3,503	3,218	(396)	4,128
Funds flow from operations <sup>2</sup>	3,450	3,223	(400)	4,137
per unit – basic and diluted <sup>3</sup>	0.37	0.34	(0.04)	0.44
Distributions declared	2,229	2,229	2,229	2,229
per Class A Unit	0.2376	0.2376	0.2376	0.2376
per Subordinated Class B Unit	0.2376	0.2376	0.2376	0.2376
<b>PARTNERSHIP UNITS OUTSTANDING<sup>1</sup></b>				
End of period	9,380,946	9,380,946	9,380,946	9,380,946
Weighted average – basic	9,380,946	9,380,946	9,380,946	9,380,946
Weighted average – diluted	9,380,946	9,390,442	9,380,946	9,380,946
	Three Months Ended Dec 31, 2006	Three Months Ended Sep 30, 2006	Three Months Ended Jun 30, 2006	30-day Period Ended Mar 31, 2006 <sup>1</sup>
<b>Financial Results</b>				
(\$'000's, except per unit amounts)				
Revenue	16,633	14,619	7,839	6,922
Gross margin <sup>2</sup>	4,906	4,194	2,315	1,769
Net earnings (loss)	(31,263)	2,500	675	1,279
per unit – basic and diluted <sup>3</sup>	(3.33)	0.27	0.08	0.14
EBITDAC <sup>2</sup>	2,886	2,596	737	1,302
Funds flow from operations <sup>2</sup>	2,917	2,635	778	1,311
per unit – basic and diluted <sup>3</sup>	0.31	0.29	0.09	0.15
Distributions declared	2,229	2,217	2,124	705
per Class A Unit	0.2376	0.2376	0.2376	0.0792
per Subordinated Class B Unit	0.2376	0.2376	0.2376	0.0792
<b>PARTNERSHIP UNITS OUTSTANDING<sup>1</sup></b>				
End of period	9,380,946	9,380,946	9,005,946	8,905,946
Weighted average – basic	9,380,946	9,244,805	8,907,045	8,905,946
Weighted average – diluted	9,380,946	9,244,898	8,912,539	8,905,946

Notes:

<sup>1</sup> From commencement of operations on March 2, 2006.

<sup>2</sup> Refer to the "Non-GAAP Measures" on page 5 for further detail.

<sup>3</sup> Includes Class A Units and Subordinated Class B Units (see "Unitholders' Equity" on page 15). Between December 31, 2007 and February 29, 2008 there has been no change in the number of Partnership Units outstanding.

## **Seasonality of Operations**

The Canadian drilling industry is subject to seasonality with activity peaking during the winter months in the fourth and first quarters. As temperatures rise in the spring, the ground thaws and becomes unstable. Government road bans severely restrict activity in the second quarter before equipment is moved for summer drilling programs in the third quarter. These seasonal trends typically lead to quarterly fluctuations in operating results and working capital requirements.

## **LIQUIDITY AND CAPITAL RESOURCES**

At December 31, 2007, the Partnership had bank indebtedness of \$4.5 million in comparison to cash and cash equivalents of \$4.2 million at December 31, 2006. Cash was used to fund the growth in operations, including the direct procurement of products and for the investment in the Edson, Alberta facility (see "Financing Activities" on page 15). Working capital was positive at \$7.6 million (December 31, 2006 - \$10.9 million).

At December 31, 2007, the Partnership had a revolving demand facility with a commercial bank and was permitted to borrow up to \$7.0 million (December 31, 2006 - \$3.0 million), subject to the value of certain accounts receivable. Any amounts drawn on this facility incurred interest at the bank's prime rate of interest plus 0.50%. The facility was secured by a general security agreement containing a first ranking security interest over all personal property of the Partnership and the General Partner as well as a \$2.0 million fixed first charge on the land and improvements of the Partnership's Edson, Alberta property with a carrying value of \$2.2 million. The facility was also secured by a guarantee provided by the General Partner for \$7.0 million. This facility was for general operating purposes and to manage cash flows during seasonal fluctuations. The amount drawn on the facility at December 31, 2007 was \$4.5 million (December 31, 2006 - nil).

Long-term debt, including current portion, at December 31, 2007 was \$2.2 million (December 31, 2006 - \$1.1 million) representing vehicle financing loans of \$1.3 million (December 31, 2006 - \$1.1 million) and a one year term loan for \$0.9 million (December 31, 2006 - nil). The term loan was established at the end of September 2007 with a commercial bank to finance the equipment purchased to date for the Edson, Alberta trucking operation. The term loan had a fixed interest rate of 6.75% and was payable over 36 months at fixed principal payments of \$28,000 per month plus interest. The loan was secured by a general security agreement containing a first ranking security interest over all personal property of the Partnership and the General Partner and a registered charge on certain equipment with a carrying value of \$1.2 million.

On February 26, 2008, the Partnership secured new financing with a commercial bank to borrow up to \$12.0 million on a demand revolving loan facility based on the value of certain accounts receivable and inventory. Any amounts drawn on this facility incur interest at the bank's prime rate plus 0.50%. At February 29, 2008 there was \$4.5 million drawn on this operating facility.

The Partnership also established two long-term committed facilities with the same commercial bank to borrow up to \$2.75 million to finance CES' recent capital asset expenditures for the Edson, Alberta facility and related equipment. At February 29, 2008 there was \$2.55 million drawn on these facilities, used in part to pay out the \$0.9 million term loan. The first committed loan was for \$1.75 million with a five year term, with the bank reserving the right to extend the term by two additional five year terms. The monthly payments are amortized over 15 years. The second committed loan was for \$0.8 million and has a five year term. Both loans incur interest at the bank's prime rate plus 0.75%.

These new facilities are secured by a general security agreement creating a first priority security interest in all personal property of the General Partner, the Partnership and its subsidiaries, an unlimited corporate guarantee of the indebtedness of the Partnership given by the General Partner and the Partnership's subsidiaries, and a demand collateral mortgage on the Partnership's Edson, Alberta property.

These new facilities were used to repay and cancel the Partnership's bank debt that was in place at December 31, 2007.

Management is satisfied that the Partnership has sufficient liquidity and capital resources to meet these long-term payment obligations.

## Funds Flow from Operations and Distributions

CES calculated distributable funds based on funds flow from operations<sup>1</sup> and the payout ratio<sup>1</sup> based on the level of distributions declared as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>3</sup>
(S)(00\$)		
Cash flow from operating activities	4,386	9,859
Adjust for:		
Change in non-cash operating working capital <sup>4</sup>	6,024	(2,218)
Funds flow from operations <sup>1</sup>	10,410	7,641
Less: Maintenance capital <sup>2</sup>	456	957
Distributable funds <sup>1</sup>	9,954	6,684
Distributions declared	8,916	7,275
Payout ratio <sup>1</sup>	90%	109%

Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" on page 5 for further detail.

<sup>2</sup> Refer to the "Operational Definitions" on page 6 for further detail.

<sup>3</sup> From commencement of operations on March 2, 2006.

<sup>4</sup> See components of change in non-cash operating working capital balances below.

Components of change in non-cash operating working capital balances – increase (decrease) in cashflow:	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
(S)(00\$)		
Accounts receivable	1,824	3,060
Inventory	(3,573)	(1,574)
Prepaid expenses	(10)	(157)
Accounts payable and accrued liabilities	(3,838)	462
Deferred revenue	(427)	427
	(6,024)	2,218

Note:

<sup>1</sup> From commencement of operations on March 2, 2006.

Distributable funds were \$10.0 million for the year ended December 31, 2007, in comparison to \$6.7 million for the 305-day period ended December 31, 2006. The Partnership declared monthly distributions of \$0.0792 per Class A Common limited partnership unit ("Class A Unit") during the period and quarterly distributions of \$0.2376 per Class B subordinated limited partnership unit ("Subordinated Class B Unit") to Subordinated Class B unitholders. Distributions on the Subordinated Class B Units are paid on a quarterly basis, subject to the Partnership achieving certain distribution targets on the Class A Units. The distributions paid per unit on the Class A Units and the Subordinated Class B Units met the per unit targets as set out in the Partnership's long form prospectus dated February 21, 2006 in connection with the Partnership's initial public offering.

The target payout ratio on an annualized basis is 80% of distributable funds. The actual payout ratio for 2007 was 90% and was 109% for the 305-day period ended December 31, 2006. Throughout the year, the actual payout ratio varies with the seasonality of the Partnership's cash flow. Periods of higher activity will cause the payout ratio to decrease, and likewise, lower activity periods will cause the payout ratio to increase. Distributions are funded by cash provided by operating activities. During periods of insufficient cash availability, due to either the seasonality of the business or changes in the level of working capital, distributions could be funded through the credit facility.

Management continues to believe that the annual target level of 80% of distributable funds is appropriate for the Partnership's business over the long term given the relatively low level of capital required to maintain and grow the business. The Board of Directors reviews the distributions on a monthly and quarterly basis in light of industry conditions and, particularly, growth opportunities requiring expansion capital and management's forecast of distributable funds.

The following chart summarizes the Partnership's distributions in relation to GAAP performance measures:

(\$000's)	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Cash flow from operating activities	4,386	9,859
Net earnings (loss)	7,301	(26,809)
Distributions declared	8,916	7,275
Shortfall (excess) of cash flows from operating activities over distributions declared	4,530	(2,584)
Shortfall of net earnings over distributions declared	1,615	34,084

Note:

<sup>1</sup> From commencement of operations on March 2, 2006.

The shortfall of cash flows from operating activities over distributions declared in 2007 resulted from the timing of the changes in certain non-cash working capital balances, namely inventory and accounts payable and accrued liabilities.

The shortfall of net earnings over distributions declared in 2007 was primarily due to the non-cash charge to earnings of \$2.0 million for future income tax expense. The shortfall for the 305-day period ended December 31, 2006 in net earnings over distributions declared was primarily due to the non-cash charge for goodwill impairment of \$34.0 million.

Subsequent to December 31, 2007, CES declared monthly distributions of \$0.0792 per Class A Unit to unitholders of record on January 31, 2008 for the month ended January 31, 2008 and also declared monthly distributions of \$0.0792 per Class A Unit to unitholders of record on February 29, 2008 for the month ended February 29, 2008.

## Investing Activities

The Partnership incurred \$5.6 million in capital expenditures during the year ended December 31, 2007 of which \$5.1 million was for expansion capital and \$456,000 was for maintenance capital. For the 305-day period ended December 31, 2006 there was \$1.9 million in capital expenditures, of which \$937,000 was for expansion and \$957,000 was for maintenance (see "Operational Definitions" on page 6).

(\$000's)	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Expansion capital	5,095	937
Maintenance capital	456	957
Total investment in property and equipment	5,551	1,894
Less:		
Accrued liabilities related to expenditures	202	-
Vehicle financing	810	896
Cash used for investment in property and equipment	4,539	998

Note:

<sup>1</sup> From commencement of operations on March 2, 2006.

The expansion capital expenditures in 2007 were primarily related to the construction of the trucking, warehousing and tank farm facility in Edson, Alberta (\$2.6 million), which was completed in the fourth quarter, and the purchase of trucks and related equipment for the Edson, Alberta operations (\$1.5 million). This facility and trucking operations are being operated under the Partnership's EQUAL Transport division which was established in the second quarter of 2007. In addition, expansion capital included vehicles and equipment purchased to service the growth in activity. Maintenance capital expenditures in 2007 primarily related to replacement vehicles for field technicians.

For the 305-day period to December 31, 2006, the Partnership incurred \$937,000 in expansion capital (primarily for land and facilities of \$265,000, the business information system of \$236,000, vehicle fleet expansion of \$183,000, trucking and tank equipment of \$154,000 and other of \$99,000) and \$957,000 for maintenance capital (primarily for vehicles of \$782,000).

Field vehicles purchased were financed by third parties and no actual cash outlay was incurred.

## **Business Acquisitions**

On March 2, 2006, the Partnership completed the acquisition of the drilling fluids businesses from Impact Fluid Systems Inc. ("Impact") and Canadian Fluid Systems Ltd. ("CFS" and collectively with Impact, the "Vendors") for an aggregate purchase price of \$86.7 million which was funded by the payment of \$50.6 million in acquisition notes, \$6.0 million payable to the Vendors, the issuance of 860,594 Class A Units and the issuance of 2,151,486 Subordinated Class B Units at the initial public offering ("IPO") price of \$10.00 per unit.

The acquisition of the drilling fluids businesses by the Partnership has been accounted for using the purchase method and earnings have been recorded from March 2, 2006.

	<b>Impact</b>	<b>CFS</b>	<b>Total</b>
	\$000's	\$000's	\$000's
<b>Net assets acquired</b>			
Current assets	17,161	10,694	27,855
Property and equipment	659	16	675
Goodwill	37,621	38,345	75,966
Current liabilities	(11,860)	(5,694)	(17,554)
Long-term debt	(220)	-	(220)
	43,361	43,361	86,722
<b>Consideration</b>			
Acquisition notes	25,301	25,301	50,602
Due to Vendors	3,000	3,000	6,000
Class A Units	4,303	4,303	8,606
Subordinated Class B Units	10,757	10,757	21,514
	43,361	43,361	86,722

The acquisition notes were repaid with proceeds from the IPO. See "Financing Activities" on page 15.

The payable to the Vendors of \$6.0 million was satisfied by the issuance of an unsecured promissory note to each Vendor in the amount of \$3.0 million. Each note was for a term of two years from the March 2, 2006 closing of the acquisitions, and was non-interest bearing for the first year of the term but was interest bearing at the Royal Bank of Canada prime rate on the second year of the term.

On May 10, 2006 the Partnership agreed to grant an option in favour of the Vendors to convert the \$6.0 million payable to the Vendors to Class A Units at a conversion price of \$10.00 per unit for a period of up to six months from March 2, 2006, the effective date of the acquisitions. On June 29, 2006, \$1.0 million aggregate principal amount of the promissory note held by Impact was assigned to a shareholder of Impact and was converted into 100,000 Class A Units at a conversion price of \$10.00 per Class A Unit, and on July 19, 2006 the \$3.0 million aggregate principal amount of the promissory note held by CFS was converted into 300,000 Class A Units at a conversion price of \$10.00 per unit.

On September 18, 2006, the Partnership extended the conversion option on the unsecured promissory notes to September 30, 2006, and a further \$750,000 aggregate principal amount was converted into Class A Units at \$10.00 per Class A Unit. During the three month period ended September 30, 2006, an aggregate of \$500,000 of the outstanding notes were repaid in cash and the remaining amount payable of \$750,000 was assigned from the Vendors to a related party who is also an officer of the General Partner. During the three month period ended December 31, 2006, the outstanding amount of \$750,000 was paid out in cash.

The above business acquisitions were transacted with certain individuals or entities controlled by them, who as a result of the acquisitions are significant unitholders of the Partnership. These individuals or persons related to them have continued in key management roles with the General Partner. These persons include Rodney L. Carpenter and Thomas J. Simons who are officers, directors and significant direct or indirect shareholders of CFS and Impact, respectively, as well as officers and directors of the General Partner. See "Transactions with Related Parties" on page 16.

## Financing Activities

On March 2, 2006, the Partnership completed the IPO of 5,893,866 Class A Units at a price of \$10.00 per Class A Unit for aggregate gross proceeds of \$58.9 million, before deducting \$3.5 million in underwriting commissions and approximately \$1.8 million in other costs relating to the IPO. Of the net proceeds, \$50.6 million was used to repay the acquisition notes issued to each of CFS and Impact (see "Business Acquisitions" on page 14) and the remaining \$3.0 million was retained in the Partnership to fund growth opportunities including the purchase of the Carlyle Facility (as defined herein, see "Transactions with Related Parties" on page 16).

There were no significant financing activities in the year ended December 31, 2007 other than the term loan for \$1.0 million (see "Liquidity and Capital Resources" on page 11).

Financing of the construction of the Edson, Alberta facility had been managed through cash flow and the operating line of credit.

On February 26, 2008, CES was successful in securing a new demand facility and two committed facilities with a commercial lender (see "Liquidity and Capital Resources" on page 11).

## Unitholders' Equity

On March 2, 2006, the Partnership closed the IPO of 5,893,866 Class A Units at a price of \$10.00 per Class A Unit, for aggregate gross proceeds of \$58.9 million and net proceeds of approximately \$53.6 million, after deducting offering expenses and underwriters' commission of approximately \$5.3 million.

In connection with the acquisition of the drilling fluids businesses, the Partnership issued an aggregate of 860,594 Class A Units and 2,151,486 Subordinated Class B Units to the Vendors as partial consideration for the acquired businesses. Of the Class A Units issued to the Vendors, 706,890 Class A Units were held in escrow with one half of the units being released from escrow on the first anniversary of the date of the acquisition, and the remaining units being released on the second anniversary of the date of the acquisition. The Subordinated Class B Units issued to CFS and Impact in connection to the acquisitions are non-transferable (except to certain shareholders, associates or affiliates of the respective Vendors) and are only exchangeable into Class A Units on or after March 2, 2009, unless a take-over bid is made for the Class A Units and in certain other limited circumstances. Distributions on the Subordinated Class B Units are paid quarterly subject to achieving certain distribution targets on the Class A Units.

The Partnership is authorized to issue an unlimited number of Class A Units and Subordinated Class B Units.

Class A Units	Number of Units	Amount (\$000's)
Issued pursuant to initial public offering	5,893,866	58,939
Less unit issue expenses	-	(5,336)
	5,893,866	53,603
Issued as consideration for acquired businesses	860,594	8,606
Issued on conversion of promissory notes	475,000	4,750
Class A Units at December 31, 2006	7,229,460	66,959

Subordinated Class B Units	Number of Units	Amount (\$000's)
Issued as consideration for acquired businesses	2,151,486	21,514
Subordinated Class B Units at December 31, 2006	2,151,486	21,514

No additional units were issued during the year ended December 31, 2007.

On March 2, 2007, one half of the 706,890 Class A Units that were being held in escrow were released from escrow. The remaining escrowed units were released from escrow on March 2, 2008.

## Unit Option Plan

The Partnership may provide additional compensation to employees, officers and directors of the General Partner and certain service providers by issuing options to acquire Class A Units under the Partnership's unit option plan (the "Unit Option Plan"). As at December 31, 2007, 938,095 (December 31, 2006 - 938,095) Class A Units were reserved for issuance under the Unit Option Plan, of which 243,095 (December 31, 2006 - 268,595) Class A Units remain available for option grants. Options granted vest as to one-third on each of the first, second and third anniversary dates of the grant and expire five years after the grant.

As part of an employee retention program and following regulatory approval, on October 6, 2006 the Partnership adjusted the exercise price of 196,500 of the outstanding Unit Options held by certain office and field employees from a weighted average exercise price of \$9.87 to \$7.79. The new exercise price reflected the then current market price of the Class A Units. The incremental value due to the reduction in the exercise price was \$50,000, which is being recognized as unit-based compensation over the remaining vesting period. The exercise price was not adjusted for any of the options held by directors, officers and other insiders of the General Partner. The option repricing was effected solely as an incentive to employees in recognition of robust labour market conditions.

## Commitments / Contractual Obligations

At December 31, 2007, the Partnership had the following financial commitments with payments due for the years ending December 31 as follows:

(\$000's)	2008	2009	2010	2011	2012	Total
Long-term debt, including current portion	905	797	413	49	30	2,194
Office rent	579	520	76	78	33	1,286
Construction of buildings	112	-	-	-	-	112
Vehicle leases	48	24	5	-	-	77
<b>Total</b>	<b>1,644</b>	<b>1,341</b>	<b>494</b>	<b>127</b>	<b>63</b>	<b>3,669</b>

Financial commitments based on the new debt facilities and including the repayment of the term loan in place at December 31, 2007 (see "Liquidity and Capital Resources" on page 11) are as follows:

(\$000's)	2008	2009	2010	2011	2012	Total
Long-term debt, including current portion	1,719	741	439	326	307	3,532
Office rent	579	520	76	78	33	1,286
Construction of buildings	112	-	-	-	-	112
Vehicle leases	48	24	5	-	-	77
<b>Total</b>	<b>2,458</b>	<b>1,285</b>	<b>520</b>	<b>404</b>	<b>340</b>	<b>5,007</b>

Given its current financial condition, the Partnership anticipates it will be able to meet these commitments as necessary.

## OFF-BALANCE SHEET ARRANGEMENTS

The Partnership does not have any off-balance sheet arrangements.

## TRANSACTIONS WITH RELATED PARTIES

There were no transactions with related parties during the year ended December 31, 2007.

On March 2, 2006, the Partnership acquired certain land, building and related equipment (the "Carlyle Facility") from persons who are non-arms length with CES. The Carlyle Facility was acquired from a corporation that was owned by Rodney L. Carpenter, Kenneth D. Zandee and a third party. Mr. Carpenter is an officer and director of the General Partner and a significant shareholder of CFS. Mr. Zandee is an officer of the General Partner and a significant shareholder of CFS. The Carlyle Facility was acquired for \$260,000 which represented fair market value.

## FOURTH QUARTER RESULTS AND DISCUSSION

	Three Months Ended Dec 31, 2007	Three Months Ended Dec 31, 2006	\$ Change	% Change
<b>(<i>\$000's, except per unit amounts</i>)</b>				
Revenue	18,600	16,633	1,967	12
Cost of sales	12,827	11,727	1,100	9
Gross margin <sup>1</sup>	5,773	4,906	867	18
% of revenue	31%	29%		
Selling, general and administrative expenses	2,270	2,020	250	12
Amortization	335	141	194	138
Impairment of goodwill	-	34,000	(34,000)	n/m
Unit-based compensation	53	39	14	36
Interest expense, net of interest income	53	(31)	84	n/m
Net earnings (loss) before taxes	3,062	(31,263)	34,325	n/m
Future income tax recovery	230	-	230	n/m
Net earnings (loss)	3,292	(31,263)	34,555	n/m
per unit – basic and diluted	0.35	(3.33)	3.68	n/m

Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" on page 5 for further detail.

n/m – Calculation is not meaningful.

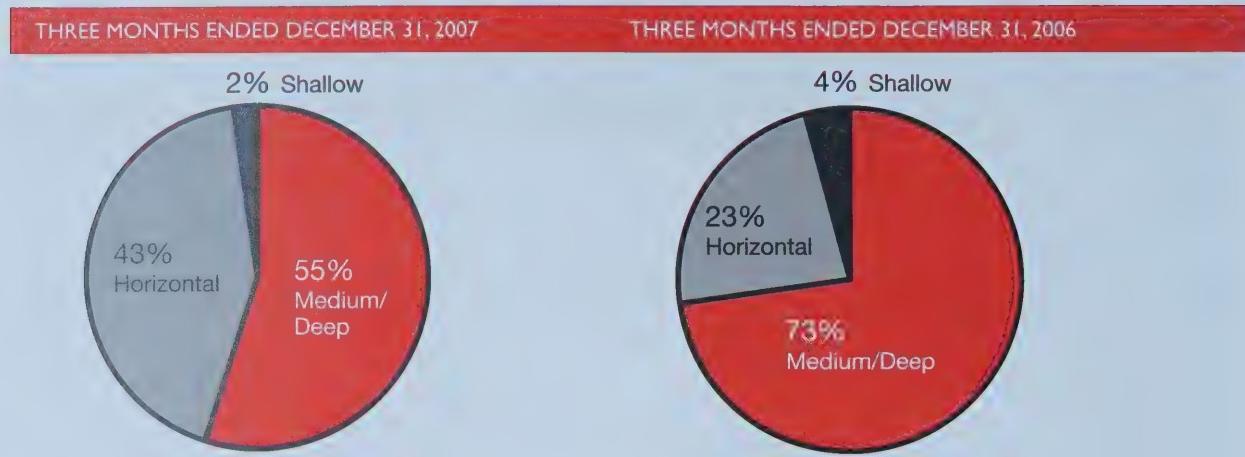
### Revenue and Operating Activities

Revenue for the three month period ended December 31, 2007 was \$18.6 million, an increase of \$2.0 million or 12% over the same quarter last year despite a significant drop in industry drilling activity. The active rig count in Western Canada averaged 342 for the fourth quarter in 2007 based on CAODC published monthly data for Western Canada. This was a 26% drop from the average rig count of 465 in the fourth quarter in 2006. CES estimated its market share in the fourth quarter of 2007 at 17%, a small increase over the 16% estimated for the fourth quarter last year.

The Partnership estimated operating days as follows:

	Three Months Ended Dec 31, 2007	Three Months Ended Dec 31, 2006
Operating days	5,520	5,244

The following charts illustrate the Partnership's estimated revenue by well type in its targeted areas:



In the fourth quarter of 2007, CES started to generate revenue from its trucking operation, EQUAL Transport, which is based out of Edson, Alberta.

### **Cost of Sales and Gross Margin**

Gross margin of \$5.8 million, or 31% of revenue, was generated for the fourth quarter in 2007. Gross margin was 29% of revenue for the fourth quarter in 2006. Margins have increased from last year due to a reduction in sales of lower margin base oil, improved procurement strategies and the start up of the trucking operation.

### **SG&A**

SG&A for the fourth quarter in 2007 was \$2.3 million, an increase of \$250,000 (12%) from the fourth quarter in 2006. This increase primarily related to higher compensation costs including sales commissions.

### **Other Expense Items**

Amortization was \$335,000 for the fourth quarter in 2007 and \$141,000 for the same period in 2006. The increase largely related to the Edson, Alberta assets that started being amortized in the fourth quarter of 2007.

Unit-based compensation was determined using the Black-Scholes option pricing model and expensed over the three-year vesting period.

Interest expense, net of interest income, in the fourth quarter of 2007 was comprised of interest expense on vehicle financing loans, the term loan and the operating loan. In the fourth quarter of 2006 interest was earned on short-term investments.

### **Future Income Taxes**

A future income tax recovery of \$230,000 was recognized in the fourth quarter of 2007 primarily due to the December 14, 2007 enactment of legislation reducing tax rates in 2011 and beyond. The tax rate expected to be in effect when the net taxable timing differences will reverse was reduced from 31.5% to 28.0%.

## Funds Flow from Operations and Distributions

CES calculated distributable funds based on funds flow from operations<sup>1</sup> and the payout ratio<sup>1</sup> based on the level of distributions declared as follows:

(\$000's)	Three Months Ended Dec 31, 2007	Three Months Ended Dec 31, 2006
Cash flow from operating activities	(384)	3,115
Adjust for:		
Change in non-cash operating working capital	3,834	(198)
Funds flow from operations <sup>1</sup>	3,450	2,917
Less: Maintenance capital <sup>2</sup>	90	265
Distributable funds <sup>1</sup>	3,360	2,652
Distributions declared	2,229	2,229
Payout ratio <sup>1</sup>	66%	84%

Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" on page 5 for further detail.

<sup>2</sup> Refer to the "Operational Definitions" on page 6 for further detail.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

CES prepares its consolidated financial statements in accordance with Canadian GAAP. There were no new accounting policies announced during the period presented which would be expected to materially impact the Partnership's consolidated financial statements.

As a routine element of the financial statement preparation process, management is required to make estimates and assumptions based on information available as at the financial statement date. These estimates and assumptions affect the reported amounts of assets and liabilities, the possible disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense for the period.

Although estimates and assumptions must be made during the financial statement preparation process, it was management's opinion that none of the estimates or assumptions were highly uncertain at the time they were made. The most significant estimates in CES' consolidated financial statements were the impairment of goodwill, the amortization of property, equipment and intangible assets and unit-based compensation.

## CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

### Comprehensive Income, Financial Instruments and Hedging

On January 1, 2007, the Partnership adopted the following Canadian Institute of Chartered Accountants ("CICA") Handbook Sections: Section 1530 – Comprehensive Income; Section 3251 – Equity; Section 3855 – Financial Instruments – Recognition and Measurement; Section 3861 – Financial Instruments – Disclosure and Presentation, and Section 3865 – Hedges, in accordance with the transitional provisions in each respective section.

Upon adoption of these standards, the Partnership has classified all financial instruments into one of the following five categories: 1) loans and receivables; 2) assets held to maturity; 3) assets available for sale; 4) other financial liabilities; and 5) held for trading. Financial instruments classified as held for trading are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in net income. Financial instruments classified as available for sale are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in other comprehensive income, until realized through disposal or impairment. All other financial instruments are accounted for at amortized cost with foreign exchange gains and losses recognized immediately in net income.

The Partnership has classified its financial instruments as follows: cash – held for trading; accounts receivable – loans and receivables; and bank indebtedness, accounts payable and accrued liabilities, distributions payable and long-term debt – other financial liabilities.

Transaction costs relating to financial instruments are expensed as incurred and included in net earnings.

The Partnership currently does not utilize hedges or other derivative financial instruments in its operations and has no embedded derivatives in any of its contracts. As a result, the adoption of CICA Handbook Section 3865 has no impact on the financial statements for this period.

## **Financial Instruments**

### **(a) Fair value**

The carrying value of amounts drawn on the revolving demand facility are equal to fair value, as interest is charged based on a floating rate. The carrying value of long-term debt is not significantly different than fair value. The carrying values of all other financial instruments approximate their fair value due to the relatively short period to maturity of the instruments.

### **(b) Credit risk**

Accounts receivable includes balances from a large number of customers operating primarily in the oil and gas industry. The Partnership assesses the creditworthiness of its customers on an ongoing basis as well as monitoring the amount and age of balances outstanding. Accordingly, the Partnership views the credit risks on these amounts as normal for the industry.

### **(c) Interest rate risk**

The Partnership is exposed to interest rate risk with respect to interest expense on its revolving demand facility and its new committed facilities.

## **Accounting Changes**

On January 1, 2007, the Partnership adopted CICA Handbook Section 1506 – Accounting Changes. This standard requires that when an entity has not applied a new primary source of Canadian GAAP that has been issued but is not yet effective, the entity shall disclose this fact and the expected impact of the new standard in the period of initial application.

At December 31, 2007, the Partnership has not adopted CICA Handbook Section 1535 – Capital Disclosures, Section 3031 – Inventories, Section 3862 – Financial Instruments – Disclosures; and Section 3863 – Financial Instruments – Presentation. Section 1535 requires the entity to disclose information about its objectives, policies and processes for managing capital, as well as its compliance with any externally imposed capital requirements. Section 3031 replaces Section 3030 – Inventories, and establishes standards for the measurement, presentation and disclosure of inventories. Section 3862 requires the entity to disclose the nature and extent of risks arising from financial instruments and how the entity manages those risks, and Section 3863 provides guidance on the presentation of financial instruments. These sections are to be applied for periods beginning on or after October 1, 2007. The Partnership intends to adopt these standards in the financial statements for the interim period ending March 31, 2008. The impact of the initial application of these standards is not expected to be significant.

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Partnership will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The impact of the initial application of these standards is not expected to be significant.

## New Accounting Developments

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public entities are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Partnership continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

Management of the Partnership is not aware of any recent accounting pronouncements or developments, other than as noted above, that will affect the Partnership's consolidated financial statements. Management will continue to monitor and assess the impact of accounting pronouncements on the Partnership's consolidated financial statements as they become available.

## RISKS AND UNCERTAINTIES AND NEW DEVELOPMENTS

The drilling industry is cyclical and the business of CES is directly affected by fluctuations in the level of oil and natural gas exploration and development activity carried on by its clients. Drilling activity is seasonal and, in turn, is directly affected by a variety of factors, including: weather; oil, natural gas and natural gas liquids prices; access to capital markets; and government policies including environmental regulations. Any prolonged or significant decrease in energy prices, economic activity or adverse change in government regulations could have a significant negative impact on exploration and development drilling activity in North America.

The oil and natural gas drilling season is affected by weather. The industry is generally more active in the WCSB during the winter months of November through March, as the movement of heavy equipment is easier over the frozen ground. Wet weather, traditionally in the spring and summer, can hamper the movement of drilling rigs which has a direct impact upon generating revenue. Conversely, a longer colder winter as well as a dry spring and summer strengthen drilling operations and therefore serve to enhance CES' revenue generation. Mitigation of weather risk is difficult and costly as effective derivative products do not yet exist to successfully manage this risk.

The ability of the Partnership to expand its services will depend upon the ability to attract qualified personnel as needed. The demand for skilled oilfield employees and drilling fluid technicians is high and the supply is limited. The unexpected loss of the Partnership's key personnel or the inability to retain or recruit skilled personnel could have an adverse effect on the Partnership's results. CES addresses this risk by:

- attracting well trained and experienced professionals;
- offering competitive compensation at all levels;
- ensuring a safe working environment with clearly defined standards and procedures; and
- offering its employees both internal and external training programs.

CES takes its environmental responsibilities seriously and has instituted standards, policies and procedures to address this risk area. In addition, the Partnership maintains insurance policies with respect to its operations providing coverage of all material insurable risks.

A concentration of credit risk exists in CES' trade accounts receivable since they are currently exclusively from companies operating in the WCSB. Significant changes in the oil and gas industry including economic conditions, environmental regulations, government policy and other geopolitical factors may adversely affect CES' ability to realize the full value of its accounts receivable. It is not possible to predict the likelihood or magnitude of this risk. CES attempts to mitigate this risk by performing credit checks as considered necessary, managing the amount and timing of exposure to individual customers and by review of its credit procedures on a regular basis.

The Government of Alberta receives royalties on production of natural resources from lands in which it owns the mineral rights. On October 25, 2007, the Government of Alberta announced a new royalty regime that will introduce new royalties for conventional oil, natural gas and oilsands that are linked to price and production levels. The new royalty regime is expected to be implemented effective January 1, 2009.

The implementation of the proposed changes to the royalty regime in Alberta are subject to certain risks and uncertainties. The significant changes to the royalty regime require new legislation, changes to existing legislation and regulation and development of software to support the calculation and collection of royalties. Additionally, certain proposed changes contemplate further public and/or industry consultation. There may be modifications introduced to the proposed royalty structure prior to the implementation thereof.

The changes to the royalty regime may adversely affect the exploration for, and the development of, oil and natural gas by entities operating in the Province of Alberta, particularly medium/deep natural gas and high productivity conventional oil, which could negatively impact the business, operations, cash flow and distributions of CES. The Partnership continues to monitor the situation and notes the Government of Alberta has indicated some willingness to alter the royalty regime to adjust for unintended consequences.

Reference should be made to the Partnership's Annual Information Form for the period ended December 31, 2007, and in particular to the heading "Risk Factors" for further risks associated with the business, operations and structure of the Partnership.

## CORPORATE GOVERNANCE

### **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to provide reasonable assurance that information required to be reported by the Partnership is gathered, recorded, processed, summarized and reported to senior management, including the President and Chief Executive Officer and the Chief Financial Officer of the General Partner, to allow timely decisions regarding required public disclosure by CES in its annual filings, interim filings or other reports filed or submitted in accordance with Canadian securities legislation.

At the end of the period covered by this MD&A, management, under the direction and supervision of the President and Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Partnership's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the period covered by this MD&A, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Partnership's annual filings and interim filings and other reports filed or submitted in accordance with Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the General Partner, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to allow decisions regarding required disclosure.

### **Internal Controls over Financial Reporting**

Management of the General Partner is responsible for designing adequate internal controls over financial reporting for the Partnership to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management, under the direction and supervision of the President and Chief Executive Officer and the Chief Financial Officer, assessed the design of the Partnership's internal controls over financial reporting as at December 31, 2007, and based on that assessment determined that there were no significant deficiencies or material weaknesses in the design of CES' internal controls over financial reporting.

It should be noted that while the General Partner's President and Chief Executive Officer and the Chief Financial Officer believe that the Partnership's disclosure controls and procedures provide a reasonable level of assurance that they are effective, and that the internal controls over financial reporting are adequately designed, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

## OUTLOOK

Management of the Partnership believes that it is well positioned with its technology-based service offerings, expanding geographic diversification and broad customer base to continue to grow the business and gain market share.

Recent strengthening of natural gas prices from the depressed levels in 2007 provides some optimism that industry drilling levels in Alberta will start to improve in 2008. However, on-going uncertainty as to the impact of the changes announced to the Alberta royalty regime may continue to result in reallocations of capital spending by CES' customers away from Alberta and towards British Columbia, Saskatchewan and international jurisdictions.

Management continues to be encouraged by the level of horizontal drilling activity in the Bakken light oil resource play in Saskatchewan, which is considered to be one of the most significant plays in the WCSB at the moment, and horizontal drilling activity in the Canadian oilsands. In addition, the emergence of the lower Shaunavon oil play in southwest Saskatchewan provides another promising area of targeted growth. These remain significant and growing markets where management expects CES' technology, such as Liquidrill™ in the Bakken and Liquidrill™/Tarbreak and Poly-Core used in the oilsands, will drive the growth of the Partnership's business.

Recent developments in the ability of operators to apply multiple fracturing techniques in horizontal wells in tight formations in the WCSB such as the Montney and the Cadomin have stimulated the drilling activity of these deeper, complex wells. CES' technologies, such as Seal-AX™ (Patent Pending), lower costs to drill these wells, which positions the Partnership to benefit from this industry development.

CES believes that its value proposition in drilling for deeper natural gas, oilsands and conventional horizontal oil wells positions the Partnership as the premium fluids provider in the market. Management is very encouraged by the strong start for 2008, as evidenced by the record level of CES jobs currently in progress. CES' technologies have global application and the Partnership will continue to pursue opportunities that align its service offerings with the needs of its customers. Management is confident that CES' technologies will be embraced as the Partnership builds out its operations in the United States. Management believes that the United States operations and the international projects that CES is pursuing will be incremental to CES' strong activity level in the WCSB. Procuring materials and providing engineering support for this new activity can be achieved in addition to sustaining the Partnership's increased level of activity in the WCSB.

**Additional information related to the Partnership can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com). Information is also accessible on the Partnership's web site at [www.CanadianEnergyServices.com](http://www.CanadianEnergyServices.com).**

# Management Report

Management is responsible for the preparation of the consolidated financial statements in accordance with generally accepted accounting principles and for the consistency therewith of all other financial and operating data presented in this annual report.

Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial and management information.

External auditors appointed by the unitholders have examined the consolidated financial statements. The Audit Committee, consisting of three non-management directors, is responsible to review these statements with management and the auditors and to report to the Board of Directors. The Board is responsible to review and approve the consolidated financial statements.

Thomas J. Simons  
President & Chief Executive Officer  
February 26, 2008

Laura A. Cillis  
Chief Financial Officer  
February 26, 2008

# Auditors' Report

To the Unitholders of Canadian Energy Services L.P.:

We have audited the consolidated balance sheets of Canadian Energy Services L.P. (the "Partnership") as at December 31, 2007 and 2006 and the consolidated statements of operations, comprehensive income and deficit and cash flow for the year ended December 31, 2007 and for the period from commencement of operations on March 2, 2006 to December 31, 2006. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2007 and 2006 and the results of its operations and its cash flow for the year ended December 31, 2007 and for the period from commencement of operations on March 2, 2006 to December 31, 2006 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants  
Calgary, Alberta  
February 26, 2008

# Consolidated Balance Sheets

Stated in thousands of dollars	Dec 31, 2007	Dec 31, 2006
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents (note 5)	\$ -	\$ 4,194
Accounts receivable	21,909	23,733
Inventory	6,186	2,613
Prepaid expenses	190	180
	28,285	30,720
Property and equipment (note 6)	6,724	2,224
Intangible assets (note 7)	95	-
Goodwill (note 8)	41,966	41,966
	\$ 77,070	\$ 74,910
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
Current liabilities		
Bank indebtedness (note 9)	\$ 4,548	\$ -
Accounts payable and accrued liabilities	14,196	17,832
Distributions payable	1,084	1,084
Deferred revenue	-	427
Current portion of long-term debt (note 10)	905	457
	20,733	19,800
Long-term debt (note 10)	1,289	616
Future income tax liability (note 11)	2,001	-
	3,290	616
Unitholders' equity		
Class A Units (note 12)	66,959	66,959
Subordinated Class B Units (note 12)	21,514	21,514
Contributed surplus	273	105
Deficit	(35,699)	(34,084)
	53,047	54,494
	\$ 77,070	\$ 74,910

Commitments (note 16)

Subsequent Events (note 21)

APPROVED ON BEHALF OF THE BOARD:

Thomas J. Simons

President & Chief Executive Officer and Director

D. Michael Stewart

Director & Chairman, Audit Committee

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statements of Operations, Comprehensive Income and Deficit

Stated in thousands of dollars except per unit amounts	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Revenue	\$ 60,420	\$ 46,013
Cost of sales	41,345	32,829
Gross margin	19,075	13,184
Expenses		
Selling, general and administrative expenses	8,622	5,663
Amortization	913	345
Impairment of goodwill (note 8)	-	34,000
Unit-based compensation (note 13)	168	105
Loss on disposal of assets (note 6)	27	-
Interest expense, net of interest income	43	(120)
	9,773	39,993
Net earnings (loss) for the period before taxes	9,302	(26,809)
Future income tax expense (note 11)	2,001	-
Net earnings (loss) for the period	7,301	(26,809)
Other comprehensive income	-	-
Comprehensive earnings (loss) for the period	7,301	(26,809)
Deficit, beginning of period	(34,084)	-
Unitholders' distributions declared (note 15)	(8,916)	(7,275)
Deficit, end of period	\$ (35,699)	\$ (34,084)
Net earnings (loss) per unit (note 14)		
Basic and diluted	\$ 0.78	\$ (2.93)

<sup>1</sup> From commencement of operations on March 2, 2006.

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statements of Cash Flow

Stated in thousands of dollars	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
<b>CASH PROVIDED BY (USED IN):</b>		
<b>OPERATING ACTIVITIES:</b>		
Net earnings (loss) for the period	\$ 7,301	\$ (26,809)
Items not involving cash:		
Amortization	913	345
Impairment of goodwill (note 8)	-	34,000
Unit-based compensation	168	105
Loss on disposal of assets	27	-
Future income tax expense (note 11)	2,001	-
Change in non-cash operating working capital (note 20)	(6,024)	2,218
	4,386	9,859
<b>FINANCING ACTIVITIES:</b>		
Units issued for cash, net of issue costs	-	53,603
Repayment of long-term debt	(689)	(227)
Increase in long-term debt	1,000	-
Distributions to unitholders	(8,916)	(6,191)
	(8,605)	47,185
<b>INVESTING ACTIVITIES:</b>		
Repayment of acquisition notes (note 4)	-	(50,602)
Repayment of promissory notes (note 4)	-	(1,250)
Investment in property and equipment (note 6)	(4,539)	(998)
Investment in intangible assets	(97)	-
Proceeds on disposal of fixed assets	113	-
	(4,523)	(52,850)
Increase (decrease) in cash and cash equivalents	(8,742)	4,194
Cash and cash equivalents, beginning of period	4,194	-
Cash and cash equivalents (bank indebtedness), end of period (notes 5 and 9)	\$ (4,548)	\$ 4,194
<b>SUPPLEMENTARY CASH FLOW DISCLOSURE</b>		
Interest paid	\$ 43	\$ -
Taxes paid	\$ -	\$ -

<sup>1</sup> From commencement of operations on March 2, 2006.

The accompanying notes are an integral part of these consolidated financial statements.

# Notes to the Consolidated Financial Statements

For the periods ended December 31, 2007 and 2006  
(Tabular amounts in thousands of dollars, except per unit amounts)

## I. The Limited Partnership

Canadian Energy Services L.P. (the "Partnership") is a limited partnership formed on January 13, 2006, pursuant to the *Limited Partnerships Act* (Ontario). The Partnership is a "Canadian partnership" as defined in subsection 102(1) of the *Income Tax Act* (Canada) (the "Act") and the terms of a limited partnership agreement dated January 13, 2006, as amended and restated on March 2, 2006 (the "Partnership Agreement"), prohibit the issuance of units to, and the admittance as partners of, persons who are non-resident of Canada for the purposes of the Act.

On March 2, 2006, the Partnership commenced business operations when it acquired the businesses of two private drilling fluid companies. Consideration for the acquisition was comprised of acquisition notes, the issuance of Class A Common limited partnership units ("Class A Units") and Class B subordinated limited partnership units ("Subordinated Class B Units"). On March 2, 2006 the acquisition notes were repaid with the proceeds from the Partnership's initial public offering ("IPO") of 5,893,866 Class A Units for aggregate gross proceeds of \$58.9 million and net proceeds of \$53.6 million after deducting underwriting commissions and certain other expenses of the IPO.

Canadian Energy Services Inc., the general partner of the Partnership (the "General Partner"), was incorporated on December 9, 2005 under the *Business Corporations Act* (Alberta). The General Partner is authorized to carry on the business of the Partnership and has full power and exclusive authority to administer, manage, control and operate the business of the Partnership. The Partnership reimburses the General Partner for all direct costs and expenses incurred in the performance of those duties.

CES Operations Ltd., a wholly-owned subsidiary of the Partnership, was incorporated on September 22, 2006. AES Drilling Fluids, LLC (formerly American Energy Services, LLC), a Delaware limited liability company of which CES Operations Ltd. is the sole shareholder, was formed on November 28, 2006. Each of the foregoing companies was formed in connection with the Partnership's operational expansion strategy into the United States.

The Partnership designs and implements drilling fluid systems for the oil and gas industry, in particular relating to drilling medium to deep vertical and directional wells and horizontal wells in the Western Canadian Sedimentary Basin. The oil and natural gas drilling season is affected by weather. The industry is generally more active during the winter months of November through March, as the movement of heavy equipment is easier over the frozen ground. Wet weather in the spring and summer can hamper the movement of drilling rigs which has a direct impact upon generating revenue. Conversely, a longer colder winter as well as a dry spring and summer strengthen drilling operations.

## 2. Basis of Presentation

The consolidated financial statements have been prepared by management of the Partnership in accordance with Canadian generally accepted accounting principles ("GAAP").

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates include providing for amortization of property and equipment and intangible assets, impairment of goodwill and unit-based compensation. Actual results could differ from these estimates.

### **3. Significant Accounting Policies**

#### **(a) Consolidation**

These consolidated financial statements include the accounts of the Partnership and its wholly-owned subsidiaries. All inter-company balances and transactions are eliminated on consolidation.

#### **(b) Cash and cash equivalents**

The Partnership considers deposits in banks, certificates of deposit and short-term investment with original maturities of three months or less from the acquisition date as cash and cash equivalents.

#### **(c) Inventory**

Inventory is stated at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

#### **(d) Property and equipment**

Property and equipment are recorded at cost less accumulated amortization. Property and equipment are amortized using the straight-line method over their estimated useful lives at the following rates:

Computer equipment and software	3 years	straight-line method
Vehicles	3 years	straight-line method
Trucks	3-5 years	straight-line method
Field equipment	5 years	straight-line method
Furniture and fixtures	5 years	straight-line method
Buildings	10-20 years	straight-line method
Tanks	15 years	straight-line method

The Partnership regularly reviews its property and equipment to account for impairment.

#### **(e) Intangible assets**

Costs attributable to intangible assets are capitalized if future economic benefits are reasonably assured. Intangible assets are initially recorded at cost and are amortized over their estimated useful lives of 10 years when the realization of economic benefits begin. Intangible assets are reviewed regularly to account for impairment.

#### **(f) Goodwill**

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values.

Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary.

The second step is necessary when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as when determined in a business combination, using the fair value of the reporting unit as if it were the purchase price. When the carrying amount of goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess. Impairment provisions are not reversed if there is a subsequent increase in the fair value of goodwill.

## **(g) Revenue recognition**

The Partnership's revenue is primarily comprised of the sale of products and the provision of services. Revenue on sales of product is recognized based on fixed or determinable prices when the product has been delivered to the well site and the product has been mixed. For sales that are invoiced upon shipment of the product, deferred revenue is recorded for the portion of the product that has not been mixed. Revenue from field service and trucking charges is recognized based upon agreed daily, hourly or job rates, when the service is performed. Revenue will only be recognized when collection is reasonably assured.

## **(h) Unit-based compensation**

The Partnership uses the fair value method to account for options granted to employees, officers and directors of the General Partner and certain service providers. Under the fair value method, the fair value of the options is estimated at the grant date using the Black-Scholes option pricing method, and such fair value is expensed over the vesting period, with a corresponding increase in contributed surplus. Any consideration received upon the exercise of the unit-based compensation together with the amount of non-cash compensation expense recognized in contributed surplus is recorded as an increase in unitholders' capital. The Partnership has not incorporated an estimated forfeiture rate for unit options that will not vest and accounts for forfeitures as they occur.

## **(i) Income taxes**

The income earned directly by the Partnership is taxed at the partner level. As a result, provisions for income and capital taxes are not made by the Partnership except as noted below. The income of the subsidiaries of the Partnership is subject to tax and the subsidiaries follow the asset and liability method of recording future income taxes. These consolidated financial statements include the assets, liabilities, and operations of the Partnership and its subsidiaries and do not include the assets and liabilities, including income tax, of the partners.

Effective January 1, 2011 the income of the Partnership will be subject to tax and accordingly future income taxes have been recorded relating to temporary differences expecting to reverse after this date. The Partnership records future income taxes using the asset and liability method. Under this method, future tax assets and liabilities are recognized for the future taxes attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax carrying values. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the period in which those temporary differences reverse. The effect of a change in tax rates on future tax assets and liabilities is recognized in income in the period that the legislation is enacted or substantively enacted.

## **(j) Foreign currency translation**

Transactions in foreign currencies are translated at rates in effect at the time of the transaction. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Gains and losses are included in net earnings.

The accounts of the Partnership's integrated foreign subsidiary are translated into Canadian dollars using average exchange rates for the month of the respective transaction for revenue and expense. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated using historical exchange rates. Gains or losses resulting from these translation adjustments are included in net earnings.

## **(k) Comprehensive income, financial instruments and hedging**

On January 1, 2007, the Partnership adopted the following Canadian Institute of Chartered Accountants ("CICA") Handbook Sections: Section 1530 – Comprehensive Income; Section 3251 – Equity; Section 3855 – Financial Instruments – Recognition and Measurement; Section 3861 – Financial Instruments – Disclosure and Presentation, and Section 3865 – Hedges, in accordance with the transitional provisions in each respective section.

Upon adoption of these standards, the Partnership has classified all financial instruments into one of the following five categories: 1) loans and receivables; 2) assets held to maturity; 3) assets available for sale; 4) other financial liabilities; and 5) held for trading. Financial instruments classified as held for trading are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in net income. Financial instruments classified as available for sale

are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in other comprehensive income, until realized through disposal or impairment. All other financial instruments are accounted for at amortized cost with foreign exchange gains and losses recognized immediately in net income.

The Partnership has classified its financial instruments as follows: cash – held for trading; accounts receivable – loans and receivables; and bank indebtedness, accounts payable and accrued liabilities, distributions payable and long-term debt – other financial liabilities.

Transaction costs relating to financial instruments are expensed as incurred and included in net earnings.

The Partnership currently does not utilize hedges or other derivative financial instruments in its operations and has no embedded derivatives in any of its contracts. As a result, the adoption of CICA Handbook Section 3865 has no impact on the financial statements for this period.

#### **(l) Earnings (loss) per unit**

Basic earnings (loss) per unit are computed by dividing net earnings by the weighted average number of units outstanding during the period. The Partnership uses the treasury stock method for calculating diluted earnings per unit. Diluted earnings per unit are computed similar to basic earnings per unit except that the weighted average units outstanding are increased to include additional units from the assumed exercise of unit options, if dilutive. The number of additional units is calculated by assuming that outstanding unit options were exercised and that the proceeds from such exercises and any unrecognized unit-based compensation in aggregate are used to acquire Class A Units at the average market price during the period.

#### **(m) Accounting changes**

On January 1, 2007, the Partnership adopted CICA Handbook Section 1506 – Accounting Changes. This standard requires that when an entity has not applied a new primary source of GAAP that has been issued but is not yet effective, the entity shall disclose this fact and the expected impact of the new standard in the period of initial application.

At December 31, 2007, the Partnership has not adopted CICA Handbook Section 1535 – Capital Disclosures, Section 3031 – Inventories, Section 3862 – Financial Instruments – Disclosures, and Section 3863 – Financial Instruments – Presentation. Section 1535 requires the entity to disclose information about its objectives, policies and processes for managing capital, as well as its compliance with any externally imposed capital requirements. Section 3031 replaces Section 3030 – Inventories, and establishes standards for the measurement, presentation and disclosure of inventories. Section 3862 requires the entity to disclose the nature and extent of risks arising from financial instruments and how the entity manages those risks and Section 3863 provides guidance on the presentation of financial instruments. These sections are to be applied for periods beginning on or after October 1, 2007. The Partnership intends to adopt these standards in the financial statements for the interim period ending March 31, 2008. The impact of the initial application of these standards is not expected to be significant.

In February 2008, the CICA issued Handbook Section 3064 - Goodwill and Intangible Assets, replacing Section 3062 - Goodwill and Other Intangible Assets and Section 3450 - Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Partnership will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The impact of the initial application of these standards is not expected to be significant.

## 4. Business Acquisitions

On March 2, 2006, the Partnership completed the acquisition of the drilling fluid businesses from Impact Fluid Systems Inc. ("Impact") and Canadian Fluid Systems Ltd. ("CFS" and collectively with Impact, the "Vendors") for an aggregate purchase price of \$80.7 million, plus a working capital adjustment of \$6.0 million. The purchase price was funded by the payment of \$50.6 million in acquisition notes payable, \$6.0 million payable to the Vendors, the issuance of 860,594 Class A Units and the issuance of 2,151,486 Subordinated Class B Units at the initial public offering (the "IPO") price of \$10.00 per unit. The working capital adjustment was determined by the Partnership within a 120-day period from the acquisition date. The acquisition has been accounted for using the purchase method and earnings have been recorded from March 2, 2006.

	Impact	CFS	Total
<b>Net assets acquired</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Current assets	17,161	10,694	27,855
Property and equipment	659	16	675
Goodwill	37,621	38,345	75,966
Current liabilities	(11,860)	(5,694)	(17,554)
Long-term debt	(220)	-	(220)
	43,361	43,361	86,722
<b>Consideration</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Acquisition notes	25,301	25,301	50,602
Due to Vendors	3,000	3,000	6,000
Class A Units	4,303	4,303	8,606
Subordinated Class B Units	10,757	10,757	21,514
	43,361	43,361	86,722

The acquisition notes were repaid with proceeds from the initial public offering (note 12).

The payable to the Vendors was satisfied by the issuance of an unsecured promissory note that was for a term of two years from March 2, 2006, at such time they become payable on demand, and was non-interest bearing for the first year of the term but was interest bearing at the Royal Bank of Canada prime rate on the second year of the term. The promissory notes carried a conversion option in favour of the holders thereof to convert the amounts payable into Class A Units at a conversion price of \$10.00 per Class A Unit for a period of up to six months from March 2, 2006, the date of the acquisitions. On September 18, 2006, the Partnership extended the conversion option on the unsecured promissory notes to September 30, 2006. During the period ended December 31, 2006, \$4.75 million aggregate principal amount of the unsecured promissory notes were converted into Class A Units at a conversion price of \$10.00 per Class A Unit and \$1.25 million was repaid in cash (note 12).

The above business acquisitions were transacted with certain individuals, or entities controlled by them, who as a result of the acquisitions are significant unitholders of the Partnership. These individuals or persons related to them have continued in key management roles with the General Partner. These individuals include Rodney L. Carpenter and Thomas J. Simons who are officers, directors and significant shareholders of CFS and Impact, respectively, as well as officers and directors of the General Partner.

## 5. Cash and Cash Equivalents

The components of cash and cash equivalents are as follows:

	Dec 31, 2007	Dec 31, 2006
Cash	\$ -	\$ 194
Temporary investments	-	4,000
	<b>\$ -</b>	<b>\$ 4,194</b>

## 6. Property and Equipment

December 31, 2007	Cost	Accumulated Amortization	Net Book Value
Computer equipment and software	\$ 376	\$ 163	\$ 213
Vehicles	1,898	555	1,343
Trucks	1,288	96	1,192
Field equipment	1,172	160	1,012
Furniture and fixtures	115	37	78
Buildings	1,678	78	1,600
Tanks	456	12	444
Land	842	-	842
	<b>\$ 7,825</b>	<b>\$ 1,101</b>	<b>\$ 6,724</b>

December 31, 2006	Cost	Accumulated Amortization	Net Book Value
Computer equipment and software	\$ 359	\$ 55	\$ 304
Vehicles	1,375	210	1,165
Trucks	119	1	118
Field equipment	287	39	248
Furniture and fixtures	125	17	108
Buildings	256	19	237
Tanks	35	-	35
Land	9	-	9
	<b>\$ 2,565</b>	<b>\$ 341</b>	<b>\$ 2,224</b>

Details of investments in property and equipment are as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Total investment in property and equipment	\$ 5,551	\$ 1,894
Less:		
Accrued liabilities related to additions (note 20)	202	-
Vehicle financing	810	896
Cash used for investment in property and equipment	<b>\$ 4,539</b>	<b>\$ 998</b>

<sup>1</sup> From commencement of operations on March 2, 2006.

During the year the Partnership disposed of assets with a total cost of \$291,000 and a total net book value of \$140,000. Proceeds realized on disposition were \$113,000 resulting in losses on disposal of \$27,000.

## 7. Intangible Assets

During the year, the Partnership capitalized costs of \$97,000 attributable to obtaining Patent Pending status on proprietary technology. Amortization recognized during the year in relation to intangible assets was \$2,000.

## 8. Goodwill

Goodwill initially recognized (note 4)	\$ 75,966
Impairment loss recognized for the period ended Dec 31, 2006	(34,000)
	41,966
Impairment loss recognized for the year ended Dec 31, 2007	-
	\$ 41,966

Effective November 1, 2007, the Partnership completed its second annual goodwill impairment test in accordance with its accounting policies (note 3). Management estimated the fair value of the Partnership's drilling fluids business (the sole reporting unit) using a number of industry accepted valuation methodologies including discounted future cash flows, comparable industry valuation multiples, recent trading activity and capital market pricing of the Partnership's units. Management concluded that the carrying value of goodwill was less than the estimated fair value and therefore no reduction in the carrying value was necessary.

Effective November 1, 2006, the Partnership completed its first annual goodwill impairment test using the same methodologies as described above, and concluded that a reduction in the carrying value of goodwill was required in the amount of \$34.0 million.

## 9. Bank Indebtedness

At December 31, 2007, the Partnership had a revolving demand facility with a commercial bank and was permitted to borrow up to \$7.0 million (December 31, 2006 - \$3.0 million), subject to the value of certain accounts receivable. Any amounts drawn on this facility incurred interest at the bank's prime rate of interest plus 0.50%. The facility was secured by a general security agreement containing a first ranking security interest over all personal property of the Partnership and the General Partner as well as a \$2.0 million fixed first charge on the land and improvements of the Partnership's Edson, Alberta property with a carrying value of \$2.2 million. It was also secured by a guarantee provided by the General Partner for \$7.0 million.

The amount drawn on the facility at December 31, 2007 was \$4.5 million (December 31, 2006 – nil).

On February 26, 2008, the Partnership established new debt facilities with a commercial bank (see note 21).

## 10. Long-term Debt

At December 31, 2007, the Partnership had long-term debt as follows:

	Dec 31, 2007	Dec 31, 2006
Vehicle financing loans	\$ 1,277	\$ 1,073
Term loan	917	-
	2,194	1,073
Less current portion	(905)	(457)
	\$ 1,289	\$ 616

Vehicle financing loans were at interest rates of 0% to 4.9%, repayable in monthly payments of \$800 - \$2,100 and are maturing from January 2009 to December 2012.

The term loan was with a commercial bank at a fixed interest rate of 6.75% and was payable over 36 months at fixed principal payments of \$28,000 per month plus interest. The loan was secured by a general security agreement containing a first ranking security interest over all personal property of the Partnership and the General Partner and a registered charge on certain equipment with a carrying value of \$1.2 million.

Principal payments were as follows for the years ending December 31:

2008	\$ 905
2009	797
2010	413
2011	49
2012	30
<b>Total</b>	<b>\$ 2,194</b>

On February 26, 2008, the Partnership established new debt facilities with a commercial bank (see note 21).

## II. Future Income Taxes

On June 22, 2007 the Government of Canada enacted new legislation imposing additional income taxes upon flow-through entities including public partnerships such as Canadian Energy Services L.P., effective January 1, 2011. Prior to 2007, the income of the Partnership was not subject to tax and therefore no future income taxes were recognized on temporary differences between amounts recorded on its balance sheet for book and tax purposes.

Based on its assets and liabilities as at December 31, 2007, the Partnership estimated the amount of its temporary differences which were previously not subject to tax and the period in which these differences will reverse. Details of taxable (deductible) temporary differences are as follows:

	Dec 31, 2007	Dec 31, 2006
Property and equipment	\$ 13	\$ (287)
Goodwill	1,648	(598)
IPO underwriting costs originally netted with unitholders' capital	(3,160)	(4,201)
<b>Net deductible temporary differences</b>	<b>\$ (1,499)</b>	<b>\$ (5,086)</b>

The Partnership estimated that the net deductible temporary differences existing at December 31, 2007 will reverse at a nil tax rate. The Partnership also estimated that \$7.1 million of net taxable temporary differences will reverse after January 1, 2011, resulting in a \$2.0 million future income tax liability. The taxable temporary differences relate principally to the projected excess of net book value of goodwill over the projected remaining tax pools attributable thereto at January 1, 2011.

As the legislation gave rise to a change in the Partnership's estimated future income tax liability in the period, the recognition of the liability was accounted for prospectively and \$2.0 million of future income tax expense was recorded for the year ended December 31, 2007.

While the Partnership believes it will be subject to tax under the new legislation, the tax rate on temporary difference reversals after 2010 may change in future periods. The amount and timing of reversals of temporary differences will also depend on the Partnership's future operating results, financings and asset acquisitions and dispositions.

A reconciliation of income taxes at Canadian statutory rates with reported income taxes is as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Net earnings (loss) for the period before taxes	\$ 9,302	\$ (26,809)
Combined federal and provincial tax rate on Specified Investment		
Flow-Through entities	0%	0%
Income tax expense at statutory rates	-	-
Increase (decrease) resulting from:		
Effect of initially enacted future rates on temporary differences	2,251	-
Effect of change in enacted future rates during the period	(250)	-
Future income tax expense for the period	\$ 2,001	\$ -

<sup>1</sup> From commencement of operations on March 2, 2006.

## 12. Unitholders' Equity

The Partnership is authorized to issue an unlimited number of Class A Units and Subordinated Class B Units.

Class A Units	Number of Units	Amount
Issued pursuant to initial public offering (note 1)	5,893,866	\$ 58,939
Less unit issue expenses	-	(5,336)
	5,893,866	53,603
Issued as consideration for acquired businesses (note 4)	860,594	8,606
Issued on conversion of promissory notes (note 4)	475,000	4,750
Class A Units at December 31, 2006 and December 31, 2007	7,229,460	\$ 66,959

Subordinated Class B Units	Number of Units	Amount
Issued as consideration for acquired businesses (note 4)	2,151,486	\$ 21,514
Subordinated Class B Units at December 31, 2006 and December 31, 2007	2,151,486	\$ 21,514

On March 2, 2006, the Partnership closed the IPO of 5,893,866 Class A Units at a price of \$10.00 per Class A Unit, for gross proceeds of \$58.9 million or net proceeds of \$53.6 million after offering expenses and underwriters' commission of approximately \$5.3 million.

In connection with the acquisition of the drilling fluid businesses, the Partnership issued an aggregate of 860,594 Class A Units and 2,151,486 Subordinated Class B Units to the Vendors as partial consideration for the acquired businesses. Of the Class A Units issued to the Vendors 706,890 Class A Units were held in escrow with one half of the units being released from escrow on March 2, 2007, and the remaining units being released on March 2, 2008. The Subordinated Class B Units issued to CFS and Impact in connection with the acquisition are non-transferable (except to certain shareholders, associates or affiliates of the respective Vendors) and are only exchangeable into Class A Units on or after March 2, 2009, unless a take-over bid is made for the Class A Units and certain other limited circumstances. Distributions on the Subordinated Class B Units are paid quarterly subject to achieving certain distribution targets on the Class A Units.

### 13. Partnership Unit Option Plan

The Partnership may provide additional compensation to the employees, officers and directors of the General Partner and certain service providers by issuing options to acquire Class A Units under the Partnership's unit option plan (the "Unit Option Plan"). As at December 31, 2007, 938,095 (December 31, 2006 - 938,095) Class A Units were reserved for issuance under the Unit Option Plan, of which 243,095 (December 31, 2006 - 268,595) Class A Units remain available for grant. Options granted vest as to one-third on each of the first, second and third anniversary dates of the grant and expire five years after grant.

A summary of changes to the Unit Option Plan for the periods ended December 31 is presented below:

	2007		2006	
	Options	Average Exercise Price	Options	Average Exercise Price
Outstanding, beginning of period	669,500	\$ 9.16	-	\$ -
Granted during period	75,000	6.07	694,500	9.16 <sup>1</sup>
Cancelled during period	(49,500)	9.80	(25,000)	9.15 <sup>1</sup>
Outstanding, end of period	695,000	\$ 8.78	669,500	\$ 9.16
Exercisable, end of period	206,667	\$ 9.10	-	\$ -

<sup>1</sup> The calculation of the average exercise price factors in the adjustment of the strike price of 196,500 options as described below.

The following tables summarize information about the Unit Options outstanding for the periods ended December 31:

2007	Options outstanding			Options exercisable	
	Range of exercise price	Options	Weighted average exercise price	Weighted average remaining term in years	Options
\$6.07 - \$8.00	305,000	\$ 7.36	3.6	76,667	\$ 7.78
\$8.01 - \$10.00	390,000	9.88	3.2	130,000	9.88
Total	695,000	\$ 8.78	3.4	206,667	\$ 9.10

2006	Options outstanding			Options exercisable	
	Range of exercise price	Options	Weighted average exercise price	Weighted average remaining term in years	Options
\$6.07 - \$8.00	234,500	\$ 7.78	4.3	-	\$ -
\$8.01 - \$10.00	435,000	9.89	4.2	-	-
Total	669,500	\$ 9.16	4.3	-	\$ -

As part of an employee retention program on October 6, 2006, the Partnership adjusted the exercise price of 196,500 of the outstanding Unit Options held by certain office and field employees from a weighted average exercise price of \$9.87 to \$7.79. The new exercise price reflected the current market price of the Class A Units. The incremental value due to the reduction in the exercise price was \$50,000, which is being recognized as unit-based compensation over the remaining vesting period. The exercise price was not adjusted for any of the options held by directors, officers and other insiders of the General Partner.

The fair value of the options granted during the year ended December 31, 2007 was \$64,000 (305-day period ended December 31, 2006 - \$435,000) and the fair value of options cancelled was \$30,000 (305-day period ended December 31, 2006 - \$20,000). During the same period, compensation costs of \$168,000 (305-day period ended December 31, 2006 - \$105,000) were recorded in the statement of operations. The compensation costs were calculated using the Black-Scholes option pricing model, assuming a risk-free interest rate of 4.5%, a yield of 11%, an expected volatility of 31% and expected lives of unit options of 5 years.

## 14. Earnings (Loss) Per Unit

The computations for basic and diluted earnings (loss) per unit are as follows:

	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>1</sup>
Earnings (loss)	\$ 7,301	\$ (26,809)
Weighted average number of units outstanding:		
Basic	9,380,946	9,152,574
Effect of unit options	2,269	13,968
Diluted	9,383,215	9,166,542
Earnings (loss) per unit:		
Basic and diluted	\$ 0.78	\$ (2.93)

<sup>1</sup>From commencement of operations on March 2, 2006.

## 15. Cash Distributions

The Partnership declares monthly distributions of cash to Class A unitholders of record as at the close of business on each monthly distribution record date. In addition, the Partnership declares quarterly distributions on the Subordinated Class B Units to unitholders of record at the close of business on each quarterly distribution record date, subject to achieving certain distribution targets on the Class A Units. The amounts of the distributions are determined by the General Partner in accordance with the Partnership Agreement on a discretionary basis. Such distributions are recorded as reductions of equity upon declaration of the distribution. The Partnership has declared distributions to holders of Class A Units and Subordinated Class B Units for the year ended December 31, 2007 as follows:

Distribution Period 2007	Distribution Record Date	Date of Distribution	Per Class A Unit	Per Subordinated Class B Unit	Total
Jan 1 - 31	Jan 31	Feb 15	\$ 0.0792	\$ -	\$ 573
Feb 1 - 28	Feb 28	Mar 15	0.0792	-	573
Mar 1 - 31	Mar 31	Apr 13	0.0792	-	573
Jan 1 - Mar 31	Mar 31	Apr 13	-	0.2376	510
Apr 1 - 30	Apr 30	May 15	0.0792	-	573
May 1 - 31	May 31	Jun 15	0.0792	-	573
Jun 1 - 30	Jun 30	Jul 13	0.0792	-	573
Apr 1 - Jun 30	Jun 30	Jul 13	-	0.2376	510
Jul 1 - 31	Jul 31	Aug 15	0.0792	-	573
Aug 1 - 31	Aug 31	Sep 14	0.0792	-	573
Sep 1 - 30	Sep 30	Oct 15	0.0792	-	573
Jul 1 - Sep 30	Sep 30	Oct 15	-	0.2376	510
Oct 1 - Oct 31	Oct 31	Nov 15	0.0792	-	573
Nov 1 - Nov 30	Nov 30	Dec 14	0.0792	-	573
Dec 1 - Dec 31	Dec 31	Jan 15	0.0792	-	573
Oct 1 - Dec 31	Dec 31	Jan 15	-	0.2376	510
Total distributions declared during the year			\$ 0.9504	\$ 0.9504	\$ 8,916

The Partnership declared distributions to holders of Class A Units and Subordinated Class B Units for the 305-day period ended December 31, 2006 as follows:

Distribution Period 2006	Per Unit	Total
Class A Units	\$ 0.7920	\$ 5,571
Class B Units	0.7920	1,704
Total distributions declared during the period		\$ 7,275

## 16. Commitments

The Partnership has commitments with payments due for the years ending December 31 as follows:

	Construction of buildings	Office rent	Vehicle leases	Total
2008	\$ 112	\$ 579	\$ 48	\$ 739
2009	-	520	24	544
2010	-	76	5	81
2011	-	78	-	78
2012	-	33	-	33
Total	\$ 112	\$ 1,286	\$ 77	\$ 1,475

## 17. Financial Instruments

### (a) Fair value

The carrying value of amounts drawn on the revolving demand facility are equal to fair value as interest is charged based on a floating rate. The carrying value of long-term debt is not significantly different than fair value. The carrying values of all other financial instruments approximate their fair value due to the relatively short period to maturity of the instruments.

### (b) Credit risk

Accounts receivable includes balances from a large number of customers operating primarily in the oil and gas industry. The Partnership assesses the creditworthiness of its customers on an ongoing basis as well as monitoring the amount and age of balances outstanding. Accordingly, the Partnership views the credit risks on these amounts as normal for the industry.

### (c) Interest rate risk

The Partnership is exposed to interest rate risk with respect to interest expense on its revolving demand facility and its new committed facilities (see note 21).

## 18. Payments to the General Partner

The General Partner will be allocated 0.01% of the income of the Partnership for each fiscal year and 99.99% of the income of the Partnership will be allocated to the holders of Class A Units and Subordinated Class B Units.

## 19. Related Party Transactions

On March 2, 2006, the Partnership acquired certain land, building and related equipment (the "Carlyle Facility") from persons who are non-arm's length with CES. The Carlyle Facility was acquired from a corporation that was owned by Rodney L. Carpenter, Kenneth D. Zandee and a third party. Mr. Carpenter is an officer and director of the General Partner and a significant shareholder of CFS. Mr. Zandee is an officer of the General Partner and a significant shareholder of CFS. The Carlyle Facility was acquired for \$260,000 which represented fair market value.

See note 4 for detail on additional related party transactions.

## 20. Supplemental Information

Components of change in non-cash working capital balances:	Year Ended Dec 31, 2007	305-day Period Ended Dec 31, 2006 <sup>†</sup>
<b>Operating:</b>		
Accounts receivable	\$ 1,824	\$ 3,060
Inventory	(3,573)	(1,574)
Prepaid expenses	(10)	(157)
Accounts payable and accrued liabilities	(3,838)	462
Deferred revenue	(427)	427
	(6,024)	2,218
<b>Investing:</b>		
Accounts payable and accrued liabilities	202	-
	\$ (5,822)	\$ 2,218

<sup>†</sup>From commencement of operations on March 2, 2006.

## 21. Subsequent Events

On January 22, 2008, the Partnership declared a monthly distribution of \$0.0792 per Class A Unit to unitholders of record on January 31, 2008.

On February 19, 2008, the Partnership declared a monthly distribution of \$0.0792 per Class A Unit to unitholders of record on February 29, 2008.

On February 26, 2008 the Partnership established a new revolving demand loan with a commercial bank permitting it to borrow up to \$12.0 million, subject to the value of certain accounts receivable and inventory, with amounts drawn on the facility incurring interest at the bank's prime rate plus 0.50%. The Partnership also established two long-term debt facilities with the same commercial bank on this date. The first, a committed loan for \$1.75 million, is repayable in fixed monthly principal payments of \$10,000 plus interest at the bank's prime rate plus 0.75%. This loan has an initial term of 60 months, with the bank reserving the right to extend the term by two further five year periods at its discretion. The second, a committed loan of \$0.8 million, is repayable over 60 months in fixed monthly principal payments of \$13,000 plus interest at the bank's prime rate plus 0.75%. All of the loan facilities are secured by a general security agreement creating a first priority security interest in all personal property of the General Partner, the Partnership and its subsidiaries, an unlimited corporate guarantee of the indebtedness of the Partnership given by the General Partner and the Partnership's subsidiaries, and a demand collateral mortgage on the Partnership's Edson, Alberta property. These new facilities were used to repay and cancel the Partnership's bank debt that was in place at December 31, 2007.

Principal payments on long-term debt based on the new debt facilities and including the repayment of the term loan in place at December 31, 2007 are as follows:

2008	\$ 1,719
2009	741
2010	439
2011	326
2012	307
<b>Total</b>	<b>\$ 3,532</b>



## Partnership Information

### BOARD OF DIRECTORS

Kyle D. Kitagawa<sup>1</sup>

Chairman

Alan D. Archibald<sup>2</sup>

Colin D. Boyer<sup>1,2</sup>

John M. Hooks<sup>2</sup>

D. Michael G. Stewart<sup>1</sup>

Thomas J. Simons

Rodney L. Carpenter

<sup>1</sup> Member of the Audit Committee

<sup>2</sup> Member of the Governance and Compensation Committee

### OFFICERS

Thomas J. Simons

President & Chief Executive Officer

Laura A. Cillis

Chief Financial Officer

Kenneth E. Zinger

Chief Operating Officer

Rodney L. Carpenter

Vice President, Business Development

Kenneth D. Zandee

Vice President, Marketing

Scott R. Cochlan

Corporate Secretary

### AUDITORS

Deloitte & Touche LLP

Chartered Accountants

Calgary, AB

### BANKERS

HSBC Bank Canada

Calgary, AB

### SOLICITORS

Blake, Cassels & Graydon LLP

Calgary, AB

### REGISTRAR & TRANSFER AGENT

Computershare Investor Services Inc.

Calgary, AB and Toronto, ON

### STOCK EXCHANGE LISTING

The Toronto Stock Exchange

Trading Symbol: CEU.UN

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Phone: 306-453-4411

Fax: 306-453-4401

### US OPERATIONS

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